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Budget 2004-2005 Highlights

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☞ INTRODUCTION

The annual budget for the year 2004-2005 was presented by the Finance Minister, Mr. P Chidambaram this year on July 8, 2004. This newsletter covers key aspects of the budget that may be of interest to a foreign investor.

Foreign Investment

In order to further encourage foreign investment, an Investment Commission (the Commission), chaired by an eminent person, is intended to be established. The Commission will have the broad authority on behalf of the Government to engage, discuss with and invite domestic and foreign businesses to invest in India. Many of the functions of the Foreign Investment Promotion Board (FIPB) are proposed to be put on the automatic route, and leave FIPB as a facilitator. Perhaps more clarification on the role of the Commission would be forthcoming in the days to come.

Current sectoral caps for foreign direct investment shall be raised in the following sectors:

Telecom: 49% to 74%
Civil aviation: 40% to 49%
Insurance: 26% to 49%

The procedures for registration and operation are to be made simpler and quicker for FIIs. Investment ceiling for FIIs in debt funds is proposed to be raised from USD 1 billion to USD 1.75 billion.

List of industries reserved for the small scale sector shall be further pruned - 85 items to be removed. This, in effect, would enable more enterprises to undertake manufacture of items reserved for the small scale sector (without obtaining an industrial licence and without undertaking an export obligation of 50% of the annual production).

Direct taxes

No income tax shall be payable on an income upto Rs 100,000.

Tax exemptions are proposed on interest earned from a Non Resident (External) Account and interest paid by banks to a Non Resident or to a Not So Ordinarily Resident on deposits in foreign currency.

Gifts from unrelated persons above Rs. 25,000 will be taxed as income; gifts received from blood relations, lineal ascendants and descendants and gifts received on certain occasions like marriage will continue to be totally exempt.

The existing additional depreciation of 15% allowed on new plant and machinery acquired or installed in an existing undertaking will continue[1]. However, in case of an industrial undertaking existing before April 1 2002, which was earlier required to achieve substantial expansion during any previous year by way of increase in installed capacity by at least

1 under Section 32(1) of the Income Tax Act, 1961.

25% to avail of such provision, the requirement of expansion has been reduced to 10% instead of 25%.

Automobile industry is proposed to be notified as being entitled to 150% deduction of expenditure on in-house research and development facilities. This will facilitate and encourage the major auto manufacturers who are currently in India to shift their research and development activities to India.

Benefit under section 801A[2] will be extended to power sector projects undertaken during the period April 1, 2004 to March 31, 2006.

Tax on long-term capital gains from securities transactions will be abolished; instead a tax on transactions in securities on stock exchanges to be levied on the buyer at the rate of 0.15% of the value of security; rate of tax on short-term capital gains from securities to be reduced to a flat rate of 10%.

Regarding benefits to the telecom sector under section 801A for services commenced before March 31, 2004, the terminal date to be extended to March 31, 2005. (The benefits under this section were earlier applicable to undertakings which had started providing telecommunication services on or before the 31st day of March, 2003)

100% deduction of profits is allowed for 10 years to companies carrying on scientific research and development and approved by the Department of Scientific and Industrial Research before April 1, 2004 – such benefit has been extended upto March 31, 2005.

Indirect taxes

The Government has an intention to align the indirect taxes tariff structure to those of ASEAN countries.

The Finance Minister has emphasized the principle that where an excise duty is levied, subject to only a few exceptions, like goods when imported, should attract an equivalent countervailing duty (CVD). Therefore, exemption from CVD enjoyed by some imported goods has been removed where there is no corresponding exemption from excise duty on Indian made goods. Customs duty on non alloy steel will be reduced from 15% to 10%; excise duty on steel will be increased from 8% to 12%[3]. Correspondingly, CVD will also be applicable to imports.

Computers have been completely exempted from excise duty.

Rate of service tax is proposed to be enhanced from 8% to 10% along with addition of a few more services[4] including airport services, services provided by transport booking agents, transport of goods by air, intellectual property services other than copyright, brokers of forward contracts, construction services in respect of commercial or industrial constructions and life insurance services to the extent of the risk premium.

An education cess of 2% is proposed on income tax, corporation tax, excise duties, custom duties and service tax.

Other proposals

A Bill for regulating Special Economic Zones is to be introduced.

Provisions of the Securitization Act, which was enacted in 2002 to enable secured creditors to recover their money from defaulting debtors, are proposed to be amended in line with the Supreme Court's concerns regarding fair deal to borrowers while ensuring that the recovery process is not delayed or hampered.

The States are to implement Value Added Tax with effect from April 1, 2005.

(Aprajaya Makkar)

[2] Section 801A of the Income Tax Act, 1961 allows for deduction in respect of profits and gains from industrial undertakings in certain cases.

[3] Excise duty on steel was reduced from 16% to 8% in the interim budget in February with the caveat that the decision will be reviewed when the regular budget is presented by the new Government.

[4] 58 services are covered so far.

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