Chapter 10: Union Budget 2012-13

Introduction

Article 112 of the Indian Constitution, says that every year "the President of India shall cause to be laid before **both the houses** of the parliament" the "**Annual Financial Statement**". This is popularly known as Budget.

- "***cause to be laid***" here means that the person through whom President acts, is Finance Minister of the country, who is known as the **custodian of the nation's Finances.**

The budget shows the estimated receipts and expenditure of the coming Financial Year. ***After the budget is presented to the house, the government needs approval of the Parliament to draw even one rupee from the Consolidated Fund of India.*** This approval comes by voting, which means that the Budget proposals must be passed by the Parliament. However, there are some charges which essentially have to be paid by the Government and for those charges no voting takes place. Thus, the expenditure embodied in the Budget Documents is of two types:

- The sums required for **charged expenditures**. These are **non-votable**.
- The sums required for **other expenditures** as mentioned in the Budget Documents. These are **votable**.

The sums are taken out from the Consolidated Fund of India.

Non Votable Charges

Non-votable charges are called **Charged Expenditures** and no voting takes place for the amount involved in these expenditures for their withdrawal from Consolidated Fund of India. This means that they have to be paid in any case, whether the budget is passed or not even passed. The charged expenditures are:

- Salary and Allowances of the President
- Salary and Allowances of the Presiding officers of the houses of parliament i.e. speaker / deputy speaker of the Lok Sabha and Chairman (Vice President) / Deputy Chairman of Rajya Sabha.
- Debt charges of Government of India.
- Salaries and allowances of the Judges of Supreme Court and High Courts.
- Pension of the retired Judges of the Supreme Court.
- Please note that Pension of the Retired judges of the High Court is NOT charged from the Consolidated Fund of India, but it is charged from the Consolidated Fund of States in question.
- Salaries and allowances of the Comptroller and Auditor General of India.
- Any other expenditure as required by the Constitution or parliament.

The above expenditures cannot be voted because; these payments are "**Guaranteed by the Constitution of India**". Though, the discussion on these expenditures can take place in any house of the parliament. The demand for grant for these charges is made on recommendation of the president. (Article 113)

Votable Charges

The Votable part is actual Budget. The expenditures in the Budget are in the forms of **Demand for Grants**. There Budget also presents ways and means – how the government would be recovering the expenditures. Generally, the demands for Grants of each and every ministry are made separately in the Budget documents and each demand for grant has the provisions under its different heads.

General Discussion after the Budget

On a day subsequent to the presentation of the Budget, the House takes up the General Discussion of the Budget which is called the **first stage followed by second stage i.e. discussion and voting on Demands for Grants.**

During the General Discussion on the Budget, the House is at liberty to discuss the Budget as a whole or any question of principle. The scope of discussion at this stage is confined to the general examination of the Budget i.e. the proper

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distribution of the items of expenditure according to the importance of a particular subject or service, the policy of taxation as is expressed in the Budget and the speech of the Finance Minister.

Standing Committee Reports:

After the General Discussion on Budget in both the Houses is over and Vote on Account is passed, the House is adjourned for a specified period. The Demands for Grants of each Ministry/Department will be examined by the concerned Standing Committee having jurisdiction over it during the said recess period. The Committee gives separate report for each Ministry. The Demands for Grants are discussed / considered in the House in the light of the reports of the Standing Committee. The reports of the Standing Committees which are of persuasive value are nevertheless treated as considered advice given by the Committee.

How members Prepare themselves for Discussions?

Before the discussion on the Demands for Grants is taken up copies of the Annual Reports on the working of the Ministries and Outcome Budgets if any, as and when received from the Ministries are placed at the Publications Counter for supply to members. Members can obtain the same from the Publications Counter of Lok Sabha. Copies of the reports of the Standing Committees pertaining to Demands for Grants are also made available to members from the Publications Counter after these are presented/laid on the Table of the House. These materials help the members to study and get ready for the discussions.

Guillotine

The **detailed discussions are followed by Guillotine**. **Guillotine refers to closure imposed** on the debate. On the last of the allotted days at the appointed time, the Speaker puts every question necessary to dispose of all the outstanding matters in connection with the Demands for Grants.

The Guillotine concludes the discussion on Demands for Grants.

Cut Motions:

After the discussions are over, the members get an opportunity to move cut motions to reduce the amount of demand. The members from particular parties or coalitions may bring their own cut motions. The members generally give notice of the Cut Motions for the reduction of the votable heads of expenditure of the Demands for Grants immediately after the Finance Minister or the Railway Minister as the case may be, has presented the Budget in the House.

- Every Cut Motion to a demand for Grant represents ***disapproval of some aspect or other of the Budget*** or the economic policy of the Government.

Accordingly Cut Motion is of three kinds:

1. If the cut motion aims that the **amount of the demand be reduced to Re. 1** it represents the complete disapproval of policy underlying the Demand. How? Because the motion aims to reduce the demand for grant which is worth Crores of Rupees to Re. 1 only, which almost finishes the demand for grant of a ministry. This is called **"policy" cut**.
2. If the cut motion aims that the amount of **demand be reduced to certain other amount**, it represents that the demand for grants should be altered. This is called **"Economy Cut"**.
3. If the Cut Motion aims that the amount of the Demand be reduced by ₹ 100" in order to **ventilate a specific grievance**, which is within the sphere of responsibility of the Government of India. This is called "**Token Cut"**. Actually, Token cut represents not many changes in the Demand for Grants but is humiliating for the Government. To be precise, *all cut motions are humiliating for the ruling party or coalition. The Cut motions provide the members maximum opportunity to examine every part of the budget and criticize the Government.*

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Mechanism and Fate of the Cut Motions

As soon as the Demands of a particular Ministry are taken up in the House, the Chair calls upon the members present in the House to hand over at the Table within fifteen minutes slips indicating the serial numbers of cut motions under the respective Demands which they would like to move and states that only those cut motions will be treated as moved.

When the debate concludes the Speaker puts the question to the house. Those in favour of the Motion say "Aye" and those who are against the motion say "No". This is followed by the then the Chair says 'I think the Ayes (or the Noes, as the case may be) have it'. If the opinion of the Chair as to the decision goes unchallenged, he says twice 'The Ayes (or the Noes, as the case may be) have it'; and the question before the House is determined accordingly.

The above process as we read in the newspapers as "Voice Vote". The opinion of the Chair should not be challenged. But if any member challenges the opinion by exclaiming "The Noes (or Ayes) have it", the chair directs that Lobbies be cleared. The division bell is rung and it means that a division (of votes) is to take place in Lok Sabha.

- The Bells may ring **continuously** which means that Division is to take place in Lok Sabha
- The Bells may ring **intermittently** which means that Division is to take place in Rajya Sabha.

Once the bells stop ringing, the outer doors are closed and staff are posted at the doors to prevent any entry or exit of the members till the division is concluded.

This is followed by a Division of votes. One procedure is Push Button Voting. The push-button-set containing Light Emitting Diode (LED) and four push buttons—a **green button** for 'AYES', a **red button** for 'NOES', a **yellow button** for 'ABSTAIN' and an **amber button** for 'PRESENT'. The division takes place and votes are recorded. There are Results Display Boards installed in the house which show the result.

- If, in a Division the number of Ayes and Noes is equal, the question is decided by the casting vote of the Chair.
- Casting Vote is cast by the Speaker of Lok Sabha and Deputy Chairman of the Rajya Sabha as the case may be.

What if opposition wins a Cut Motion?

The Cut Motions are mostly defeated **because of the Number strength** of the ruling party or coalition. As the cut motion is a veto power given to the member of the Lok Sabha to oppose a demand in the financial bill discussed by the government, it is seen as an effective tool to test the strength of the government. If a cut motion is adopted by the House and the government does not have the numbers, it is **obliged** to resign. That is why, when cut motions are moved, the Government starts trembling.

Finance Act and Appropriation Act:

Please note that Voting on demands does not conclude the formalities connected with provisions of funds to the Government. Next come two financial legislations. One is **Appropriation Act** and another is **Finance Act**.

- **Appropriation Act** fixes the amount which can be drawn out of the Consolidated Fund of India for meeting the expenditures for each grant.
- The **Finance Act,** deals with the legislation which authorizes the raising of Funds through taxation.

What is Vote on Account?

The Budget is presented in the month of February, and it is not possible to vote the Demands for Grants before the 31st March when the financial year ends. So in order to keep the Government functioning pending the voting of the final supply and providing the House to have a fuller opportunity to discuss the Demands in detail, in March every year, the House is asked to vote usually two months' supply, i.e. approximately 1/6th of the total estimated expenditure under various grants. This is called Vote on Account and is taken separately for Demands for Grants General and Railways. Vote on Account is passed after general discussion on the Budget. Usually it is treated as a formal matter and is passed without discussion. Vote on account is as per provisions of Article 116 of the Constitution.

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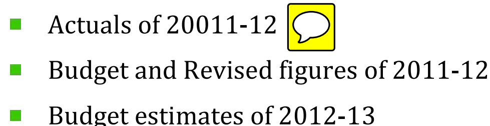
This module discusses with the economy part of the Budget along with a reference to the latest Union Budget of India. The Budget gives the complete picture of the estimated receipts and expenditures of the Government of India for that year. This picture is actually based upon the budget figures of the previous 2 years. There are three kinds of figures in this set. If we are studying the budget of 2012-13, then this set would be made up of :



- Actuals of 20011-12
- Budget and Revised figures of 2011-12
- Budget estimates of 2012-13

What is the difference between Revised estimates, Quick Estimates and Advance Estimates?

The Budgetary estimates are based upon the previous data. Similarly provisional estimates are also based upon the previous data. When these data are revised as per the current position, they are called "Revised Estimates". However, if the Revised estimates show the latest short term situation, then they are called "Quick Estimates". Advance estimates are a kind of "Quick Estimates" which are done ahead of the time.

Revenue Budget & Capital Budget

We can divide the Union Budget in two parts viz. **Revenue Budget** (or Current Budget) and **Capital Budget.**

- The **Revenue Budget** of the Government of India deals with the receipts from **taxation, and from non-tax resources such as borrowings and the expenditure met out of these receipts**.
- The Capital Budget of the Government of India, which is also known as capital account consists of the **Capital Expenditures and Capital receipts**.

Apart from that we have several heads under the expenditures such as developmental and non-developmental, plan and non-plan expenditures.

Revenue & Receipts:

The term is made up of two words revenue and receipts. Every form of money generation such as income and earnings are Revenues for the Government "if they don't increase the liability" of the Government.

- For example, if Government of India borrows money from IMF, it will increase its liabilities so cannot be called revenue.

So, the essential thing is that Revenue is all that income that does not increase financial liability. It may include for example, the money received as taxes and money received as grant. Accordingly, this revenue is divided into *Tax Revenue* and *Non-Tax revenue.*

- Receipts mean what the Government actually gets or accrues. Receipts may be Revenue or Non Revenue or capital Receipts.

Revenue Receipts of the Government

The Revenue Receipts of the Government are Tax Revenues and Non-Tax Revenues. The Tax Revenues include direct taxes and indirect taxes. Out of the tax collection, there is a share of the state governments which is disbursed to them as per the recommendations of the Finance Commission. What left is the **Net to centre tax revenue**, which is calculated in the Union Budget.

The Non Tax Revenue Receipts are those revenue receipts which are not generated by taxing the public. These may include:

- Money which the Government earns as "**Dividends and profits**" from its profit making public enterprises (PSUs).
- **Interest** which the Government earns on the money lent by it to external or internal borrowers. Thus this revenue receipts may be in foreign currency as well as Indian Rupees.

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- The money which the government receives out of its **fiscal services** such as stamp printing, currency printing, medal printing etc.
- Money which the Government earns from its "**General Services**" such as power distribution, irrigation, banking services, insurance, community services etc. which make the part of the Government business.
- Money which the government accrues as fees, fines, penalties etc.
- Grants the Government of India receives from the external sources. In case of the state Governments, it may be the internal grant from the central Government.

Revenue Expenditure

While the Revenue Receipts are those incomes of the Government of India which don't create additional liability on the Government, the *Revenue Expenditures are those expenditures which don't involve "creation of any productive assets*". These kinds of expenditures can be identified easily as they don't produce any assets.

Normally, the revenue expenditures are used either in "running" of a business or the Government. Some of the Revenue expenditures are discussed here:

- The **interest paid** by the Government of India on all the internal and external loans does not produce any assets, so it is a revenue expenditure.
- **The salaries and Pension** paid by the Government to Government employees is needed to run the Government's business. It is a revenue expenditure.
- The **subsidies** forwarded by the government to all sectors does not produce any productive asset, so it is a revenue expenditure.
- The **defense expenditures** which are needed for smooth operation of the standing armed forces is a revenue expenditure.
- The **postal expenditures** and deficits are Revenue expenditures.
- The money spent of **maintaining the law and order** situation of the country is also revenue expenditures.
- The money spent on **various social services** such as public health, education, poverty alleviation, scholarships, etc. all revenue expenditures.
- The **grants** given by the Government of India to stats and other countries is a Revenue expenditures.

Revenue Deficit & Revenue Surplus

If the balance of the Total Revenue receipts of the Government and total revenue expenditures is negative, it is called Revenue Deficit. If it is positive, it would be called Revenue surplus.

- ✓ The term Revenue deficit and fiscal deficit are being used in the Government of India Budget since the fiscal year 1997-98. In these years the Government budget has shown the negative balance means that the revenue receipts of the Government have been less than the revenue expenditures.
- ✓ The revenue expenditures is a consumptive kind of expenditures and that is why the Governments try to minimize the Revenue deficit. The Revenue deficit does not add into the production of productive assets so, it is considered dangerous to have a large revenue deficit.

Revenue surplus is good because it would give the government some opportunity to use some of the surplus in those activities which might create some productive assets. But the revenue surplus is not appreciated. The reason is that it may have its other impact on the economy. We can easily understand that if the Tax revenue of the Government is increased, it may give the Revenue surplus to the Government. But ultimately it would not be judicious to burden the public with large taxes. Further, large taxes would result in Tax evasion, corruption and problem of black money. So, the aim of the governments is to have a judicious tax structure, so that the balance is near Zero.

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In the Budget of India, the revenue deficit is as follows:

Revenue Deficit = Revenue expenditure – Revenue Receipts

Revenue Deficit (17-1)	252252 (3.3)	307270 (3.4)	394951 (4.4)	350424 (3.4)

Effective Revenue Deficit

- The concept of Effective Revenue Deficit was introduced in the Budget 2010-11 to address the structural imbalances in the revenue account. From 2012-13 onwards the Effective Revenue Deficit is being brought in as a fiscal parameter. Effective Revenue Deficit is the difference between revenue deficit and grants for creation of capital assets. Focusing on this will help in reducing the consumptive component of revenue deficit and create space for increased capital spending.

The effective revenue deficit in the Union Budget is as follows:

Effective Revenue deficit = Revenue Deficit - Grants for creation of Capital Assets

Effective Revenue Deficit (20-18)	164765 (2.1)	160417 (1.8)	257446 (2.9)	185752 (1.8)

Capital Budget

Capital Budget of the Government of India which is also known as Capital account consists of the receipts and expenditures of the Capital by the Government.

Capital Receipts

All the non-revenue receipts are known as **Capital Receipts**. They are under the following heads:

- ✓ **Loan Recovery:** The money which the Government of India had lent in the past to the states, to the PSUs and to the Union Territories, and to the parties and Governments abroad, when recovered back, are called Capital Receipts.
  - Though, the Loan recovery is Capital Receipt, the interest received on these loans is Revenue receipts as discussed above.
- ✓ **Borrowings by the Government:** The Government is the biggest borrower in the country. It borrows from the market sources, it borrows from inside as well as outside the country. All these borrowings are called capital receipts.
  - The interest paid on such borrowings is placed under Revenue expenditures.
- ✓ **Other Receipts:** The other receipts include the money in the PPF, Postal deposits, other small deposit schemes, sale of the Government bonds. All of them are a kind of loan which the Government needs to pay back with expenditures of interest on them.

Capital Expenditures

The Capital expenditure of the Government of India on capital items such as loans is called Capital expenditures. They are under several heads as follows:

- ✓ **Loan disbursals:** The loans given by the Government to the states, PSUs and other governments is called Capital Expenditure.
- ✓ **Loan Repayments:** The loans which the Government of India had taken in the past, when are returned back are included in the capital expenditures.
- ✓ **Plan Expenditures of State Government:** The state plans need money from the central Government, so it is a Capital expenditure.
- ✓ **Plan Expenditure of the central Government:** The Planned development which results in assets of the country is called capital expenditure.

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- ✓ **Capital Expenditure on Defense:** The purchase of arms and equipments, modernization of the army is a Capital Expenditure.
    - o The money spent on Defense is a non plan expenditure. It includes both the revenue expenditures and capital expenditures.
- ✓ **Other Liabilities:** The other liabilities include all other payment liabilities of the Government which are of non revenue nature.

Is there anything like Capital Deficit?

In Public Finance or Economy, The term Capital Deficit is not used. We can hear or read about Capital crunch in newspapers, which generally refers to the expenditures needed by the Government for Capital Expenditures.

Fiscal Deficit

The **Revenue Receipts + Capital Receipts** make the **Total Receipts** of the Government. The **Revenue expenditures + the Capital Expenditures** make the **Total Expenditure of the Government**. When the Balance of the Total Receipts and Total Expenditures is negative the budget is a deficit budget. The precise definition of the Fiscal Deficit in India's Budget is as follows:

- Fiscal Deficit = **Total Expenditure – (Revenue Receipts + Recoveries of Loans + Other Receipts)**

Fiscal Deficit {16-(1+5+6)}	373591 (4.9)	412817 (4.6)	521980 (5.9)	513590 (5.1)

✍ The Fiscal deficit of the Government of India is shown from 1997-98 budget.

Primary Deficit

The Revenue expenditures include the interest liabilities of the Government. If the interest liabilities are NOT included from the revenue deficit, it is called primary Deficit.

Primary Deficit = Fiscal Deficit – Interest Payments

Primary Deficit (22-11)	139569 (1.8)	144831 (1.6)	246362 (2.8)	193831 (1.9)

Is India's Budget a Deficit Budget or Surplus Budget?

A deficit budget shows that the government proposes to spend more in the coming year than its receipts. A surplus Budget shows that Government will get more receipts and spend less. In a country like India which is developing country, the needs for development ask the Government to always present a "deficit budget". This is because; the deficit budget symbolizes the concerns of the Government towards the development activities. In India a surplus budget was NEVER presented.

What is Deficit Financing?

Then Government, when proposes a deficit budget is well aware of the fact that its total expenditures are going to be more than its receipts. So, it adopts the policies and process which can sustain the burden of the deficit. The process of supporting **the budget deficit of the country is called Deficit Financing**. There are several methods of Deficit Financing such as External borrowing, External Aid, Internal Borrowing, Printing of new currency etc.

- The External Borrowing is cheaper in long term and comes in foreign exchange, which the Government can use to meet its fiscal deficit.
- External grant comes as free, but in recent years, external grant has been very low.
- Printing Currency is used by the Government **as last resort** in deficit financing. The printing of currency has its own side effects such as increasing inflation and pressure on the Government for upward revision of the wages. Further, printing currency does not meet the expenditures which are needed to be met with foreign currency only.

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India's Budget at a Glance

The following snippet from Latest Union Budget shows the important figures:

(करोड़ रुपए) (In crore of Rupees)

	2010-2011 वास्तविक Actuals	2011-2012 बजट अनुमान Budget Estimates	2011-2012 संशोधित अनुमान Revised Estimates	2012-2013 बजट अनुमान Budget Estimates
1. Revenue Receipts	**788471**	**789892**	**766989**	**935685**
2. Tax Revenue (net to centre)	*569869*	*664457*	*642252*	*771071*
3. Non-Tax Revenue	*218602*	*125435*	*124737*	*164614*
4. Capital Receipts (5+6+7)$	**408857**	**467837**	**551730**	**555241**
5. Recoveries of Loans	*12420*	*15020*	*14258*	*11650*
6. Other Receipts	*22846*	*40000*	*15493*	*30000*
*7. Borrowings and other liabilities **	*373591*	*412817*	*521980*	*513590*
8. Total Receipts (1+4)$	**1197328**	**1257729**	**1318720**	**1490925**
9. Non-Plan Expenditure	**818299**	**816182**	**892116**	**969900**
10. On Revenue Account of which,	*726491*	*733558*	*815740*	*865596*
11. Interest Payments	*234022*	*267986*	*275618*	*319759*
12. On Capital Account	*91808*	*82624*	*76376*	*104304*
13. Plan Expenditure	**379029**	**441547**	**426604**	**521025**
14. On Revenue Account	*314232*	*363604*	*346201*	*420513*
15. On Capital Account	*64797*	*77943*	*80404*	*100512*
16. Total Expenditure (9+13)	**1197328**	**1257729**	**1318720**	**1490925**
17. Revenue Expenditure (10+14)	*1040723*	*1097162*	*1161940*	*1286109*
18. Of Which, Grants for creation of Capital Assets	*87487*	*146853*	*137505*	*164672*
19. Capital Expenditure (12+15)	*156605*	*160567*	*156780*	*204816*
20. Revenue Deficit (17-1)	**252252 (3.3)**	**307270 (3.4)**	**394951 (4.4)**	**350424 (3.4)**
21. Effective Revenue Deficit (20-18)	**164765 (2.1)**	**160417 (1.8)**	**257446 (2.9)**	**185752 (1.8)**
22. Fiscal Deficit {16-(1+5+6)}	**373591 (4.9)**	**412817 (4.6)**	**521980 (5.9)**	**513590 (5.1)**
23. Primary Deficit (22-11)	**139569 (1.8)**	**144831 (1.6)**	**246362 (2.8)**	**193831 (1.9)**

The most important figures from the above table are as follows:

- Size of the Budget of the Union Government this year is ₹ 1490925 Crore. The simple balance sheet of the Budget 2012-13 is as follows:

Income of the Government			Expenditure of the Government		
Item	**Money**	**% Total Budget**	**Item**	**Money**	**%of Total Budget**
Revenue Receipts	935685	62.8	Non-Plan Expenditure	969900	65.1
Capital Receipts	555241	37.2	Plan Expenditure	521025	34.9
Total Receipts	1490925	100.0	Total Expenditure	1490925	100.0

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Revenues & Receipts of Government of India

In the above simple balance sheet, we see that the government is supposed to get ₹ 935685 Crore via Revenue Receipts and ₹ 555241 Crore via Capital Receipts which are 62.8 & 37.2 % of the total receipt respectively.

The break up of the Revenue Receipts is as follows.

Revenue Receipt in Budget 2012-13	
1. Tax Revenue	
Gross Tax Revenue	1077612
Corporation Tax	373227
Taxes on Income	195786
Wealth Tax	1244
Customs	186694
Union Excise Duties	194350
Service Tax	124000
Taxes on Union Territories	2310
Less - NCCD transferred to the National Calamity Contigency Fund/National Disaster Response Fund	4620
Less - State's share	301921
1(a) Centre's Net Tax Revenue	771071
2. Non-Tax Revenue	
Interest receipts	19231
Dividend and Profits	50153
External Grants	2887
Other Non Tax Revenue	91207
Receipts of Union Territories	1136
Total Non Tax Revenue	164614
Total Revenue Receipts (1a+2)	935685

In the table shown in the left, we see that out of the Gross Tax Revenue of ₹ 1077612 Crore, the share of states is ₹ 301921 Crore which comes out to be around 28%. The Centre's net Tax revenue is ₹ 771071 Crore Rupees after deducting ₹ 4620 Crore which is transferred to NDRF.

Please note these important points about the NDRF:

- National Disaster Response Fund has been constituted under the **Disaster Management Act 2005**, which stipulates creation of NDRF at the National level and constitution of **State Disaster Response Fund** at the State level respectively.
- The erstwhile National Calamity Contingency Fund (NCCF) is to be merged into the National Disaster Response Fund, and NCCF will cease to exist.
- NDRF is operated by the (Ministry of Home Affairs) Government of India for the purpose of providing immediate relief to people affected by the above mentioned calamities which are assessed as being of severe nature.
- **NDRF is classified in the Public Account of India**. Contributions made by any person or institution for the purpose of disaster management will also be credited to the NDRF. This means that to release the funds from NDRF, Government does not seek parliament's approval. However, since the NDRF is classified as part of Public Account of India, the government is also need to reimburse the fund.
- Expenditure fron, NDRF is meant to assist a State to provide immediate relief in those cases of severe calamity, where the expenditure required is in excess of the balance in the State's SDRF.

The above table also makes it very clear that the *largest source of revenue for the Government has been the Corporation Tax*, followed by Income Tax and Union Excise Duties. In recent year, the sevice tax has also been a source of substantial tax revenue for the Government. To proceed ahead, it would be better if we have a look at fundamentals of the taxation system in India.

The constitution of India gives taxation powers to both centre and states. Accordingly the following kinds of taxes are prevalent in India in the basis of their collection and usage.

Taxes Levied by the Central Government

The taxes which are levied exclusively by the Union Government are mentioned in the Union List of 7th schedule of the Constitution of India. They are as follows:

1. Taxes on income other than Income Tax
2. Corporation tax
3. Custom Duties
4. Excise Duties except on the alcohol liquors and narcotics (which are not contained in medical or toilet preparations)
5. Estate and succession duties other than the agricultural lands.
6. Taxes on the capital value of the assets except the agricultural land of the individuals and companies.
7. Taxes **other than** the stamp duties on transactions in stock exchanges and future markets.
8. Taxes on sales / purchase of the newspapers and the advertisements in those newspapers.
9. Taxes on the Railway freight and fares.
10. Terminal taxes on goods and passengers carried by the railways, sea or air.

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11. Taxes on the sale and purchase of the goods in case of Inter-state trade.

Taxes Levied by the State Governments

The state list of the 7th schedule of the Constitution of India enlists the taxes which come within the jurisdiction of the state Governments. They are as follows:

1. The Land Revenue
2. Taxes on Sales and Purchases of the goods except the newspapers.
3. Taxes on agricultural income.
4. Taxes on lands and buildings.
5. Succession and estate duty on agricultural lands.
6. Excise duty on alcohol and other narcotics.
7. Taxes on entry of the goods in local area.
8. Taxes on consumption of sale of the electricity/
9. Stamp duties except the duty on the financial documents.
10. Taxes on mineral rights except those minerals which are subject to any parliamentary law.
11. Taxes on goods and services inland transport.
12. Taxes on entertainment, gambling, lotteries or other luxuries.
13. Toll Taxes.
14. Taxes on professions, traders and employments.
15. Capitation taxes.
16. All advertisements except newspaper advertisements.

Certain Taxes levied as Concurrent Powers

The Union and the State Governments have the concurrent powers to fix **the principles** on which taxes on motor vehicles shall be levied and to impose stamp duties on non-judicial stamps.

Here a thumb rule works as follows:

"the property of the Union is exempted from State Taxation and the property of the states is exempted from the Union Taxation. But the parliament of India can pass legislation for taxation by Union Government of any business activities / trade of the state which are not the ordinary functions of the state".

However please note that

✓ **The Taxation powers are listed either in the State List or in the Central List, but not in the Concurrent List. It is for the first time that the tax base is proposed to be shared between the Centre and the states under the Proposed GST.**

But the states can also delegate the central government to collect certain taxes such as estate taxes.

✍ Further, please note that the Union Government has exclusive powers to impose taxes which are not specifically mentioned in the state or concurrent lists.

The taxes mentioned above clearly demarcate the financial powers of the state Governments and the Central Government. The Constitution of India says that for the revenues of the certain areas, on the Union List have to be allocated partly or wholly to the states. However, there are provisions for the same. These provisions are summarized as under:

1. There are certain duties which are **levied by the Union but are collected and appropriated by the States.** These are the Stamp Duties and excise duties on the medical items containing the alcohol and narcotics.
2. There are certain taxes which are levied and collected by the Union but entire proceeds of these taxes are assigned to the state. Such taxes are
   i. Succession and estate duties.

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ii. Terminal taxes on goods and passengers.

iii. Taxes in transaction in stock exchanges and future markets

iv. Taxes on the sale and purchase of the newspapers and advertisements therein.

3. There are central Taxes on the income and Union excise duties are levied by the Union but are allotted to the states in a prescribed manner. The question is who determines which share is to get how much? This is done by the Parliament.

Direct Taxes

The tax revenue of the Central Government is of three types:

1. Income Tax
2. Property Tax
3. Commodity Tax or Tax on goods and services

Out of above three, the first two are called **direct taxes**, while 3rd is called Indirect tax.

Income Tax:

There are two kinds of Income Taxes viz. Personal Income Tax and Corporation Tax. Personal Income tax is levied on individuals by the **Central Government**. The levy of the Income tax follows the principle of "ability to pay". This means that those who can pay more should pay more to the Government. On the basis of this certain people have been exempted from the Income Tax and the minimum exempt limit has been varying. The Exemption limit was while ` 40000 in 1995-96 budget, it is ₹ 200,000 in the latest Budget.

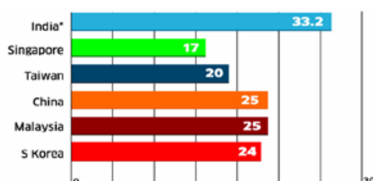
The latest income tax slabs are as follows:

Income	Existing (%)	New (%)
Up to 1.80 Lakh	Nil	Nil
1.80 to 2 Lakh	10	Nil
2L to 5L	10	10
5 L to 8 L	20	20
8 L to 10 L	30	20
Above 10 L	30	30

The above rates of Income tax are applicable to individuals aged below 60. Unlike the 2011-12, when income up to ₹ 1.9 Lakh was tax exempt for women, there is no separate provision for this time. Those above 60 are exempt for tax till 2.5 Lakh and those above 80 except till ₹ 5 Lakh.

Corporate Tax

Corporation Tax is levied on the net income of the companies. The rates of corporate taxes were very high once upon a time. They were reduced gradually since liberalization and it was pegged at around 35% in 2005-06. At present effective corporate tax is 33.2%. So, India has moved progressively towards lowering of the Corporate Income Tax rates and the results have been good for the companies as well as the Government. However, the tax regime is still complicated. The following graphic shows a comparison of India with some other countries. The picture says that still India is ahead of many economies in terms of corporation tax.



Indirect Taxes

The Taxes on the good and services have been an important source of revenue for the Government of India. This includes the custom duties which are imposed on the products that are imported and the products that are exported.

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Since, the export duties reduce the competitiveness of the Indian products in the international markets, the Government has abolished the export duties. The import duty has been quite productive for the country, particularly when it is levied on high value imports such as iron and steel etc.

The custom duties were very important in the decades of 50s and 60s and later their place was taken by the excise duties. The Central excise duties are levied by the Government on the products that that manufactured within the country.

✓ However, the commodities on which the State Government levies the duties are exempted from the central excise duties.

The Service tax was imposed in India initially from 1994-95 on electricity services, telephone services, brokerage etc. with every passing year, more and more services were brought into the ambit of the service tax. The first year collection of the Service Tax in 1994-95 was ` 407 Crore, which rose to ` 2610 Crore in 2001-02.

Number of services in the tax net	
2010-11	114
2005-06	80
2002-03	51
1998-99	26
1995-96	3

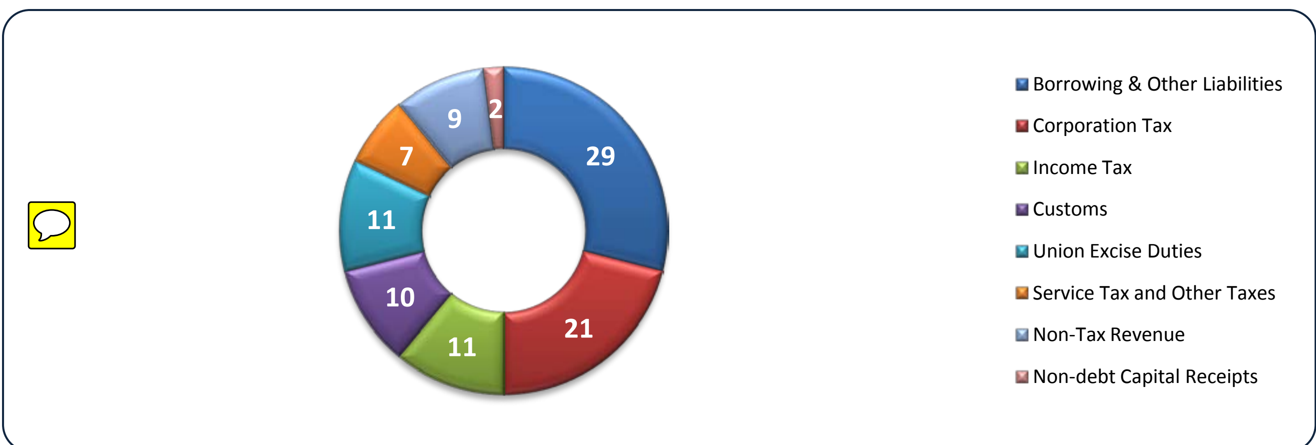
Initially the indirect tax regime was too complicated and there was an ubiquitous problem of **tax on tax.** Post liberalization, there is a lot of change in the Indirect tax administration of the country and there was a dramatic change when the country shifted to VAT regime in 2000s. From 1990-91 to till date the custom duties have also fallen drastically as shown in the figure in left, which shows the average custom collection on the products.

Capital Receipts of the Government

Capital Receipts	
A. Non-debt Receipts	
1. Recoveries of loans and advances@	11650
2. Miscellaneous Capital Receipts	30000
Total	41650
B. Debt Receipts*	
3. Market Loans	479000
4. Short term borrowings	9000
5. External Assistance (Net)	10148
6. Securities issued against Small Savings	1198
7. State Provident Fund (Net)	12000
8. Other Receipts (Net)	2245
Total	513590
Total Capital Receipts (A+B)	555241

The table in the left shows the Capital Receipts of the Government. Capital receipts are those funds which are not part of the **operating activities of the Government.** Capital Receipts includes market loans, external loans, small savings Government Provident Funds, Accretions to various Deposit Accounts, Depreciation and Reserve Funds of various departments like Railways. The nature of the capital receipts is so that **most of them** (not all of them) **are debts** and shown as liabilities of the Government's balance sheet.

From the table it is clear that **market borrowings are the largest source of capital receipts of the Government.**



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When we break up the revenue receipts and capital receipts, we can derive the above chart which shows from where a rupee comes to the central Government this year.

Expenditure Budget – 2012-13

All the expenditures that are incurred on the public exchequer of the country are kept in two categories viz. Plan and Non Plan.

- Out of them all those expenditures which are **done by the Government of India in the name of Planning** is Plan expenditure. All other expenses are **Non-plan expenditures**.
- The above is a thumb rule, in practice all the **expenditures which create some tangible or even intangible assets are Plan expenditures** while **all non asset building are non plan expenditures**. So, as per their nature, these expenses are called the Developmental or Non-developmental expenditures also. Please remember this.

✓ It's worth note that prior to 1997-98 Budget, the budget used to show the development and non development expenditures. They are now written Plan and Non Plan expenditures as per the recommendations of the "**Sukhmay Chakraborty Committee**"

The following table gives a glance to the expenditures of the Government

Non Plan Expenditure		
A. Revenue Expenditure		
1	Interest Payments and Prepayment Premium	319759
2	Defence Services	113829
3	Subsidies	190015
4	Grants to State and U.T. Governments	64211
5	Pensions	63183
6	Police	35611
7	Assistance to States from National Calamity Contigency Response Fund (NDRF)	4620
8	Other General Services (Organs of State, tax collection, external affairs etc.)	21382
9	Social Services (Education, Health, Broadcasting etc.)	20784
10	Economic Services (Agriculture, Industry, Power, Science & Technology, etc.)	24105
11	Postal Deficit	5727
12	Expenditure of Union Territories without Legislature	3875
13	Amount met from National Calamity Contigency Fund/Disaster Response Fund (NDRF)	-4620
14	Grants to Foreign Governments	3114
Total Revenue Non-Plan Expenditure		865596
B. Capital Expenditure		
1	Defence Services	79579
2	Other Non-Plan Capital Outlay	23971
3	Loans to Public Enterprises	465
4	Loans to State and U.T. Governments	85
5	Loans to Foreign Governments	550
6	Others	-346
Total Capital Non-Plan Expenditure		104304
Total Non-Plan Expenditure		969900
2. PLAN EXPENDITURE		
A. Revenue Expenditure		
1	Central Plan	303528
2	Central Assistance for	116985
	State & Union Territory Plans	
	State Plans	113170
	Union Territory Plans	3815
	Total Revenue Plan Expenditure	420513
B. Capital Expenditure		
1	Central Plan	87499
2	Central Assistance for	13013
	State & Union Territory Plans	
	State Plans	11079
	Union Territory Plans	1934
	Total Capital Plan Expenditure	100512
	Total - Plan Expenditure	**521025**
	Total Budget Support for Central Plan	391027
	Total Central Assistance for State & UT Plans	129998
	TOTAL EXPENDITURE *	1490925

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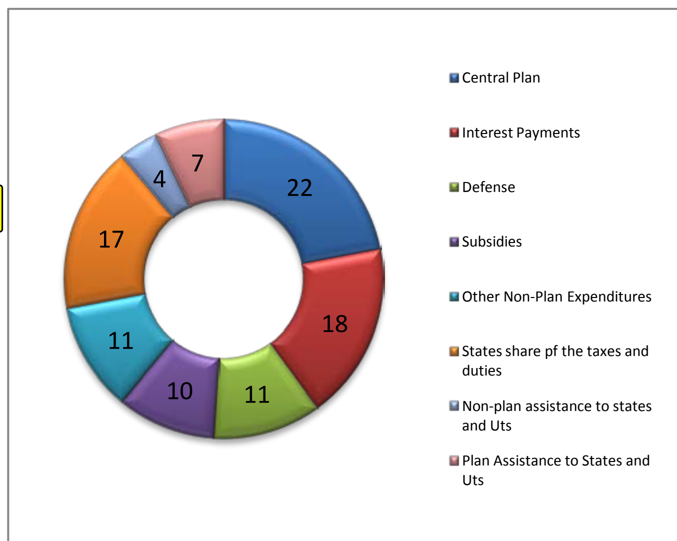
Here is the chart that shows the break-up of the **Expenditure of the Rupee** of the central Government.



Various schemes and programmes of social sector come under the Central Plan under which the Government budgets to spend ₹ 303528 Crore as Revenue Expenditure this year and ₹ 87499 as Capital Expenditures. This total amount is Rs. 391027 Crore. Apart from that the central plan will be supported by Internal and Extra Budgetary Resources (IEBR) of Public Enterprises (PEs), etc. which stands at Rs. 260482 Crore. Thus the central plan stands at Rs. 651509 Crore Rupees this year. The following snippet shows it:

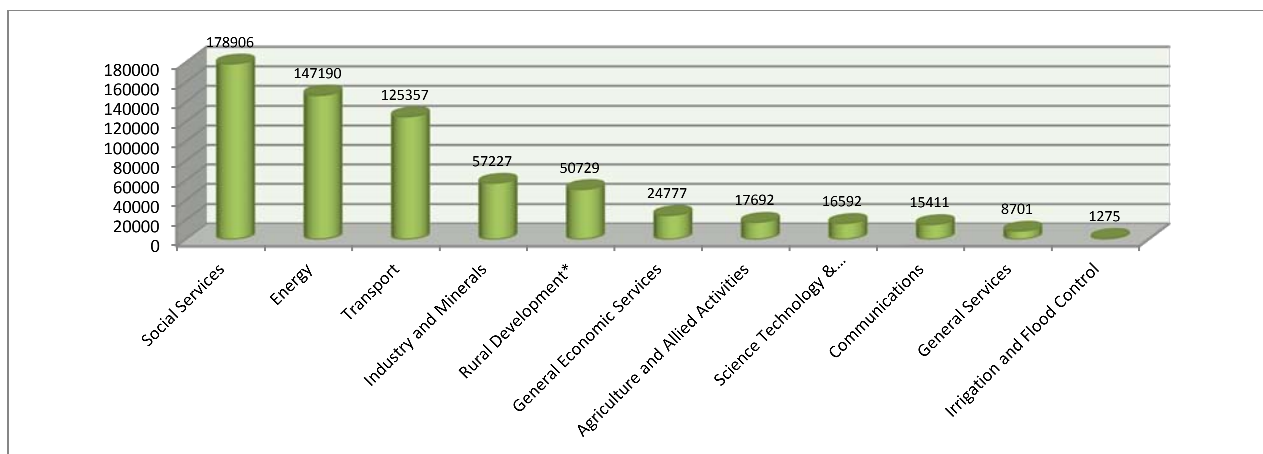
(करोड़ रुपए) (In crore of Rupees)

	2010-2011 वास्तविक Actuals	2011-2012 बजट अनुमान Budget Estimates	2011-2012 संशोधित अनुमान Revised Estimates	2012-2013 बजट अनुमान Budget Estimates
Budget Support	**285950**	**335521**	**321406**	**391027**
Internal and Extra Budgetary Resources(IEBR) of Public Enterprises (PEs), etc.	178366	256936	236766	260482
Total - Central Plan Outlay	**464316**	**592457**	**558172**	**651509**

Here is how the Government wants to spend the money from the Central Plan on various sectors:

Sectors	2010-11 actuals	2011-12 budget	2011-12 revised	2012-13 budget
Agriculture and Allied Activities	15716	14744	14855	17692
Rural Development*	52397	55288	48128	50729
Irrigation and Flood Control	476	565	489	1275
Energy		110977	155495	147190
Industry and Minerals	35951	45214	40581	57227
Transport**	94205	116861	109205	125357
Communications	10336	20256	11994	15411
Science Technology & Environment	11921	16186	12713	16592
General Economic Services	13681	15802	19420	24777
Social Services	117296	144816	148060	178906
General Services	1360	7230	5536	8701
GRAND TOTAL	464316	592457	558172	651509

These sectors are shown in the following graphics:



The decreasing order of the expenditures in the central plan is as follows:

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Social Services →Energy →Transport →Industry & Minerals →Rural Development

Now, lets have a look on expenditure of the Government on various schemes. Here is a list of schemes which incur largest expenditures.

Scheme	Budget Outlay ` crore
Mahatma Gandhi National Rural Employment Guarantee Scheme	33000
Sarva Shiksha Abhiyan	25555
Pradhan Mantri Gram Sadak Yojana	24000
National Rural Health Mission	20542
Integrated Child Development Services	15850
National Programme of Mid Day Meals in Schools	11937
Investment in National Highways Authority of India	11472
Indira Awas Yojana	11075
Drinking Water	10500
Rashtriya Krishi Vikas Yojana (This comes in states plan)	9217
Rajiv Gandhi Grameen Vidyutikaran Yojana	4900
New & Renewable Energy	4145
Rural Sanitation	3500
Equity investment in Metro Rail Projects	3168
Rashtriya Madhyamik Shiksha Abhiyan	3124
Restructured Accelerated Power Development and Reforms Programme	3114
Integrated Watershed Management Programme	3050
Universal Service Obligation	3000
Aajeevika (National Rural Livelihood Mission)	2915
National Food Security Mission	1850
National Mission on Micro Irrigation	1500
National Horticulture Mission.	1350
Ecology and Environment and National River Conservation.	1330
Prime Minister's Employment Generation Programme.	1276
Crop Insurance (3 schemes).	1135
National E-Governance programme	975
Rajiv Gandhi Scheme for Empowerment of Adolescent Girls (SABLA).	750
Construction of Rural Godowns	716
Indira Gandhi Matritva Sahyog Yojana	520
Integrated Child Protection Scheme	400
National Knowledge Network	360
National Rural Health Mission for Development of AYUSH	280
National Innovation Fund	100

Here we discuss the main points about some of the above mentioned schemes:

MGNREGA

- National Rural Employment Guarantee Act was enacted in September, 05.
- It seeks to provide for the enhancement of livelihood security of the households in rural areas of the country by providing at least one hundred days of guaranteed wage employment in every financial year to every household whose adult members volunteer to do unskilled manual work. Implemented by the Ministry of Rural Development, Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) is the flagship programme of the Government that directly touches lives of the poor and promotes inclusive growth.
- MNREGA was launched on February 2, 2006 from Anantapur in Andhra Pradesh and initially covered 200 "poorest" districts of the country. The Act was implemented in phased manner – 130 districts were added in 2007–08. With its spread over 625 districts across the country, the flagship program of the UPA Government has the potential to increase the purchasing power of rural poor, reduce distress migration and to create useful assets in rural India. Also, it can foster social and gender equality as 23% workers under the scheme are Scheduled Castes, 17% Scheduled Tribes and 50% women.
- The Outlay for MNREGS is down from nearly Rs 36,000 crore in 2010-11 to Rs 31,000 crore in the revised estimates for the current year and just Rs 33,000 crore in the coming year.

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Sarva Shiksha Abhiyan (SSA)

- Sarva Shiksha Abhiyan (SSA) is Government of India's flagship programme for achievement of Universalization of Elementary Education (UEE) in a time bound manner, as mandated by 86th amendment to the Constitution of India making free and compulsory Education to the Children of 6-14 years age group, a Fundamental Right.
- SSA is being implemented in partnership with State Governments to cover the entire country and address the needs of 192 million children in 1.1 million habitations. The programme seeks to open new schools in those habitations which do not have schooling facilities and strengthen existing school infrastructure through provision of additional class rooms, toilets, drinking water, maintenance grant and school improvement grants.
- Existing schools with inadequate teacher strength are provided with additional teachers, while the capacity of existing teachers is being strengthened by extensive training, grants for developing teaching-learning materials and strengthening of the academic support structure at a cluster, block and district level. SSA seeks to provide quality elementary education including life skills. SSA has a special focus on girl's education and children with special needs. SSA also seeks to provide computer education to bridge the digital divide.

Pradhan Mantri Gram Sadak Yojana

- Pradhan Mantri Gram Sadak Yojana (PMGSY) was launched on 25th December 2000 as a fully funded Centrally Sponsored Scheme to provide all weather road connectivity in rural areas of the country.
- The primary objective of the PMGSY is to provide Connectivity, by way of an All-weather Road (with necessary culverts and cross-drainage structures, which is operable throughout the year), to the eligible unconnected Habitations in the rural areas, in such a way that all Unconnected Habitations with a population of 1000 persons and above are covered in three years (2000-2003) and all Unconnected Habitations with a population of 500 persons and above by the end of the Tenth Plan Period (2007).
- In respect of the Hill States (North-East, Sikkim, Himachal Pradesh, Jammu & Kashmir, Uttaranchal) and the Desert Areas (as identified in the Desert Development Programme) as well as the Tribal (Schedule V) areas, the objective would be to connect Habitations with a population of 250 persons and above.

National Rural Health Mission

- The National Rural Health Mission (2005-12) seeks to provide effective healthcare to rural population throughout the country with special focus on 18 states, which have weak public health indicators and/or weak infrastructure. These 18 States are Arunachal Pradesh, Assam, Bihar, Chhattisgarh, Himachal Pradesh, Jharkhand, Jammu & Kashmir, Manipur, Mizoram, Meghalaya, Madhya Pradesh, Nagaland, Orissa, Rajasthan, Sikkim, Tripura, Uttaranchal and Uttar Pradesh. The Mission is an articulation of the commitment of the Government to raise public spending on Health from 0.9% of GDP to 2-3% of GDP. It aims to undertake architectural correction of the health system to enable it to effectively handle increased allocations as promised under the National Common Minimum Programme and promote policies that strengthen public health management and service delivery in the country.

It has as its key components provision of a female health activist in each village; a village health plan prepared through a local team headed by the Health & Sanitation Committee of the Panchayat; strengthening of the rural hospital for effective curative care and made measurable and accountable to the community through Indian Public Health Standards (IPHS); and integration of vertical Health & Family Welfare Programmes and Funds for optimal utilization of funds and infrastructure and strengthening delivery of primary healthcare. It seeks to revitalize local health traditions and mainstream AYUSH into the public health system.

The Goals of the NRHM are as follows"

- Reduction in Infant Mortality Rate (IMR) and Maternal Mortality Ratio (MMR)

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- Universal access to public health services such as Women's health, child health, water, sanitation & hygiene, immunization, and Nutrition.
- Prevention and control of communicable and non-communicable diseases, including locally endemic diseases
- Access to integrated comprehensive primary healthcare
- Population stabilization, gender and demographic balance.
- Revitalize local health traditions and mainstream AYUSH
- Promotion of healthy life styles

Integrated Child Development Services (ICDS)

The Integrated Child Development Services (ICDS) Scheme was launched in 1975 as a Centrally Sponsored Scheme with the following objectives:

- 1.To improve the nutritional and health status of children below the age of six years and pregnant and lactating mothers
- 2. To lay the foundation for the proper psychological, physical and social development of the child
- To reduce the incidents of mortality, morbidity, malnutrition and school dropouts
- To achieve effective coordination of policy and implementation among various departments to promote child development
- To enhance the capability of the mother to look after the health and nutritional needs of the child through proper health and nutrition education.

The Scheme provides for a package of services to children below 6 years and pregnant women and lactating mothers, comprising (i) Supplementary nutrition (ii) Immunization, (iii) Health check-ups, (iv) Nutrition and Health eduction, (v) Referrals, (vi) Pre-school, non formal education. The gender promotion of the girl child by trying to bring her at par with the male child is a key component of the scheme.

For nutritional purposes ICDS is provides 300 calories (with 8-10 grams of protein) every day to every child below 6 years of age. For adolescent girls it is up to 500 calories with up to 25 grams of protein everyday. Delivery of services under ICDS scheme is managed in an integrated manner through Anganwadi centres, its workers and helpers. The services of Immunisation, Health Check-up and Referral Services delivered through Public Health Infrastructure under the Ministry of Health and Family Welfare. UNICEF has provided essential supplies for the ICDS scheme since 1975. World Bank has also assisted with the financial and technical support for the programme. The cost of ICDS programme averages $10–$22 per child a year.

National Programme of Mid Day Meals in Schools

- National Programme of Nutritional Support to Primary Education (NP-NSPE) was launched as a Centrally Sponsored Scheme on 15th August 1995, initially in 2408 blocks in the country. By the year 1997-98 the NP-NSPE was introduced in all blocks of the country. It was further extended in 2002 to cover not only children in classes I-V of government, government aided and local body schools, but also children studying in EGS and AIE centres. Central Assistance under the scheme consisted of free supply of food grains @ 100 grams per child per school day, and subsidy for transportation of food grains up to a maximum of **Rs.**50 per quintal.
- In September 2004 the scheme was revised to provide cooked mid day meal with 300 calories and 8-12 grams of protein to all children studying in classes I-V in Government and aided schools and EGS/AIE centers. In addition to free supply of food grains, the revised scheme provided Central Assistance for (a) Cooking cost @ Re 1 per child per school day, (b) Transport subsidy was raised from the earlier maximum of **Rs.**50 per quintal to **Rs.**100 per quintal for special category states, and **Rs.**75 per quintal for other states, (c) Management,

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monitoring and evaluation costs @ 2% of the cost of food grains, transport subsidy and cooking assistance, (d) Provision of mid day meal during summer vacation in drought affected areas.

- In July 2006 the scheme was further revised to provide assistance for cooking cost at the rate of (a) **Rs.**1.80 per child/school day for States in the North Eastern Region, provided the NER states contribute **Rs.**0.20 per child/school day, and (b) **Rs.**1.50 per child/school day for other States and UTs, provided that these States and UTs contribute **Rs.**0.50 per child/school day.

Objectives

The objectives of the mid day meal scheme are:

- Improving the nutritional status of children in classes I-V in Government, Local Body and Government aided schools, and EGS and AIE centres.
- Encouraging poor children, belonging to disadvantaged sections, to attend school more regularly and help them concentrate on classroom activities.
- Providing nutritional support to children of primary stage in drought affected areas during summer vacation.

Programme Intervention and Coverage

To achieve the above objectives a cooked mid day meal with nutritional content as shown in column 3 of the table below will be provided to all children studying in classes I-V:

Objectives a cooked mid day meal with nutritional		
Nutritional Content	**Norm as per NP-NSPE, 2004**	**Revised Norm as per NP-NSPE, 2006**
Calories	300	450
Protein	8-12	12
Micronutrients Adequate	Not Prescribed	quantities of micronutrients like iron, folic acid, vitamin-A etc.

Components of the revised scheme The revised scheme provides for the following components:

- Supply of free food grains (wheat/rice) @ 100 grams per child per School Day from the nearest FCI godown
- Reimbursement of the actual cost incurred in transportation of food grains from nearest FCI godown to the Primary School subject to the following ceiling :
  - **Rs.**100 per quintal for 11 special category States viz. Arunachal Pradesh, Assam, Meghalaya, Mizoram, Manipur, Nagaland, Tripura, Sikkim, J&K, Himachal Pradesh and Uttarakhand, and
  - **Rs.**75 per quintal for all other States and UTs
- Provision of assistance for cooking cost at the following rates :
  - States in North-Eastern Region: @ **Rs.**1.80per child per school day provided the State Govt. contributes a minimum of 20 paise.
  - For other States & UTs : @ **Rs.**1.50 per child per school day provided the State Govt./UT administration contributes a minimum of 50- paise.

State Governments/UT administrations are required to provide the above minimum contribution in order to be eligible for the enhanced rate of Central assistance mentioned above.

- Provision of assistance for cooked Mid-Day Meal during summer vacations to school children in areas declared by State Governments as "drought-affected".
- Provision of assistance to construct kitchen-cum-store in a phased manner up to a maximum of **Rs.**60,000 per unit. However, as allocations under MDMS for construction of kitchen-cum-store for all schools in next 2-3 years may not be

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adequate states would be expected to proactively pursue convergence with other development programmes for this purpose. (Also please see para 2.5 in this regard).

- Provision of assistance in a phased manner for replacement of kitchen devices at an average cost of **Rs.**5,000 per school. The States/UT administration will have the flexibility to incur expenditure on the items listed below on the basis of the actual requirements of the school (provided that the overall average for the State/UT administration remains **Rs.**5000 per school).
  - Cooking devices (Stove, Chulha, etc.)
  - Containers for storage of food grains and other ingredients.
  - Utensils for cooking and serving.
- Provision of assistance to States/UTs for Management, Monitoring & Evaluation (MME) at the rate of 1.8% of total assistance on
  - Free food grains,
  - Transport cost and
  - Cooking cost. Another 0.2% of the above amount will be utilized at the Central Government for management, monitoring and evaluation.

Indira Awas Yojana

Indira Awas Yojana is a Centrally Sponsored scheme. Under this scheme w.e.f. 01-04-2008, the assistance has been enhanced from Rs.27500/- per beneficiary to Rs.38500/- per beneficiary, and is being given to **BPL families for the construction of new houses** . Gram Sabha does the selection of beneficiaries under this scheme. This scheme is being financed by Centre and State Government on 75:25 sharing basis.

Rastriya Krishi Vikas Yojana

The National Development Council, under the Chairmanship of Prime Minister, adopted a resolution reaffirming its commitment to achieve 4 % annual growth in agriculture sector during 11th Plan. Accordingly, a State Plan scheme, Rashtriya Krishi Vikas Yojana (RKVY) was introduced to incentivize States through additional resources for agriculture in their State Plans over and above their baseline expenditure to bridge critical gaps. District plans will be formulated, and based on that, State Plans will be made for agriculture and allied sector keeping agro-climatic conditions of each region in mind. Budget 2012-13 provides Rs. 9217 crore for this Scheme. Provision includes subcomponents as follows:

- Special Initiative for pulses and oilseeds development in selected pulses/oilseed growing villages as a supplementary programme, specifically targeted to rainfed areas and will be implemented on same parameters as ongoing programmes for oilseed and pulses
- Scheme to bridge yield gap in agriculture in eastern India
- Requirement for Saffron Mission in Jammu & Kashmir
- Promotion of oil palm
- Initiative on vegetable clusters
- Nutri-cereals
- Accelerated fodder development programme
- National Mission for Protein Supplement to promote livestock development, dairy farming, piggery, goat rearing and fisheries in selected block and Rainfed Area Development Programme

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Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY)

Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY) was launched in April-05 by merging all ongoing related schemes. Under the programme 90% grant is provided by Govt. of India and 10% as loan by REC to the State Governments. REC is the nodal agency for the programme. The RGGVY aims at:

- Electrifying all villages and habitations as per new definition
- Providing access to electricity to all rural households
- Providing electricity Connection to Below Poverty Line (BPL) families free of charge

Please note that a village would be declared as electrified, if basic infrastructure such as Distribution Transformer and Distribution lines are provided in the inhabited locality as well as the Dalit Basti hamlet where it exists. Electricity is provided to public places like Schools, Panchayat Office, Health Centers, Dispensaries, Community centers etc.The number of households electrified should be at least 10% of the total number of households in the village.

Infrastructure under RGGVY:

- Rural Electricity Distribution Backbone (REDB) with 33/11 KV (or 66/11 KV) sub-station of adequate capacity in blocks where these do not exist.
- Village Electrification Infrastructure (VEI) with provision of distribution transformer of appropriate capacity in villages/habitations.
- Habitations above 100 population are being covered under the scheme. During XI Plan, 327 projects costing Rs.16,268 Crore have been sanctioned for electrification of 49,383 villages and for providing 162 lakh electricity connections BPL households. Andaman & Nicobar Islands, Chandigarh, Dadra & Nagar Haveli, Daman & Diu, Delhi, Goa, Lakshadweep, Puducherry are not participating in RGGVY programme.

Rashtriya Madhyamik Shiksha Abhiyan (RMSA)

Rashtriya Madhyamik Shiksha Abhiyan (RSMA) is aimed at expanding and improving the standards of secondary education — classes VIII to X. The RSMA would also take secondary education to every corner of the country by ensuring a secondary school (up to class X) within a radius of 5km for every neighbourhood. Rashtriya Madhyamik Shiksha Abhiyan (RMSA) which is the most recent initiative of Government of India to achieve the goal of universalisation of secondary education (USE).

The vision for secondary education is to make good quality education available, accessible and affordable to all young persons in the age group of 14-18 years.

Objectives:

- To provide a secondary school within a reasonable distance of any habitation, which should be 5 kilometer for secondary schools and 7 -10 kilometers for higher secondary schools
- Ensure universal access of secondary education by 2017 (GER of 100%), and
- Universal retention by 2020,
- Providing access to secondary education with special references to economically weaker sections of the society, the educationally backward, the girls and the disabled children residing in rural areas and other marginalized categories like SC, ST, OBC and Educationally Backward Minorities (EBM)

Goal and Objectives

In order to meet the challenge of Universalisation of Secondary Education (USE), there is a need for a paradigm shift in the conceptual design of secondary education. The guiding principles in this regard are; Universal Access, Equality and Social Justice, Relevance and Development and Curricular and Structural Aspects. Universalisation of Secondary Education gives opportunity, to move towards equity. The concept of 'common school' will be encouraged. If these

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values are to be established in the system, all types of schools, including unaided private schools will also contribute towards Universalisation of Secondary Education (USE) by ensuring adequate enrolments for the children from under privileged society and the children Below Poverty Line (BPL) families.

Restructured Accelerated Power Development and Reforms Programme

The Govt. of India has proposed to continue R-APDRP during the XI Plan with revised terms and conditions as a Central Sector Scheme. The focus of the programme shall be on actual, demonstrable performance in terms of sustained loss reduction. Establishment of reliable and automated systems for sustained collection of accurate base line data, and the adoption of Information Technology in the areas of energy accounting will be essential before taking up the regular distribution strengthening projects. Read More Here

Integrated Watershed Management Programme

In 1977-78, **Desert Development Programme** (DDP) was launched for hot desert areas of Rajasthan, Gujarat, Haryana and cold desert areas of Jammu & Kashmir and Himachal Pradesh. Similarly, in 1989, **Integrated Watershed Development Programme (IWDP)** was launched under the aegis of National Wasteland Development Board for development of wastelands on watershed basis.

In this context, In 1994, a Technical Committee under Chairmanship of Professor **C.H. Hanumantha Rao** was appointed to appraise the impact of DPAP / DDP and suggest measures for improvement. The committee recommended a common set of operational guidelines and expenditure norms for the three programmes of Ministry of Rural Development.

Accordingly, the Guidelines for watershed Development were framed and brought into force from 1st April 1995. These guidelines were changed in 2001 and further in 2003 and were named " **Haryali Guidelines**". Later, the 11th Plan has stressed upon developing concerted action plans for rainfed areas in close consultation with the State Governments. Accordingly, the Common Guidelines for Watershed Development, 2008 have been issued and made effective from 1.4.2008. Since 26.2.2009, the three watershed programmes of the Department of Land Resources namely DPAP, DDP and IWDP have been consolidated as a comprehensive programme named '**Integrated Watershed Management Programme (IWMP)**'.

So, at present, the Integrated Wastelands Development Programme (IWDP), Drought Prone Areas Programme (DPAP) and Desert Development Programme (DDP) are running as a consolidated single programme named **Integrated Watershed Management Programme** (IWMP) in place of all the above mentioned three Area Development Programmes. (Information related to this topic is outdated in most books). This programme comes under Ministry of Rural Development.

Swarnjayanti Gram Swarojgar Yojana

Swarnjayanti Gram Swarojgar Yojana (SGSY) has been redesigned and restructured into the National Livelihood Mission (NRLM). The idea has been conceived as a cornerstone of national poverty reduction strategy. The objective of the Mission is to reduce poverty among rural BPL by promoting diversified and gainful self-employment and wage employment opportunities which would lead to an appreciable increase in income on sustainable basis. In the long run, it will ensure broad based inclusive growth and reduce disparities by spreading out the benefits from the islands of growth across the regions, sectors and communities

Chapter 11: Analysis of the Union Budget 2012-13

On Tax Proposals

Concluding the latest budget speech, Pranab Mukhrejee said that:

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My proposals on Direct Taxes are estimated to result in a net revenue loss of `4500 crore for the year. Proposals relating to Indirect Taxes are estimated to result in a net revenue gain of `45,940 crore, leaving a net gain of `41,440 crore in the Budget.

We see that this budget has saved is Rs 4,500 crore in direct taxes, but taken away 10 times that through indirect taxes, making the Rs 41,440 crore mop-up the largest ever. Excise duty is up across the board, and almost all services — including eating out, mobile bills and AC rail travel will now cost more. The increased I-T exemption limits that could save individual taxpayers up to Rs 22,600 annually would cost the exchequer Rs 4,500 crore. Then minister, quoting from Shakespeare's Hamlet. "***I must be cruel only to be kind***, "takes away ten times what he gave by hiking service tax rates and excise and customs duties, and widening the scope of service taxes. His cruelty is expected to get an additional Rs 45,940 crore from these changes in indirect tax rates. That left him with a net mop-up of Rs 41,440 crore, the highest any FM has ever managed.

The raising in the indirect taxes would mean a higher cost of living.

- The hike in I-T exemption limit from Rs 1.8 lakh to Rs 2 lakh saves men Rs 2,060 in annual taxes, but women gain only Rs 1,030 since they had a higher limit of Rs 1.9 lakh.

Impact of Budget on Tax payers

Positive	Negative
▪ I-T exemption limit raised to Rs 2 lakh ▪ 30% tax bracket now at Rs 10L ▪ Interest up to Rs 10,000 on saving bank account to be exempt from tax ▪ Deduction of 50% for investments up to Rs 50,000 in equity by new investors with an annual income up to Rs 10 lakh ▪ 5. Age limit for senior citizens reduced from 65 to 60 for several tax benefits Deduction of Rs 5,000 for preventive check-up expenses allowed within health insurance benefit	▪ Additional deduction for infra bonds of Rs 20,000 removed Income tax officers can now reopen assessments pertaining to foreign assets for up to 16 years instead of the current six years

Impact of Budget on Consumers

Positive	Negative
▪ Threshold for payment of service tax on apartment maintenance raised from Rs 3,000/mth to Rs 5,000 ▪ No excise on branded silver jewellery ▪ Duty-free baggage allowance at airports raised by Rs 10,000 to Rs 35,000 ▪ Excise duty on branded readymade garments reduced from 4.6% to 3.7%	▪ Service tax (cess included) up from 10.3% to 12.36% ▪ Excise hiked ▪ Excise duty on cars of 1500cc and above raised to 27%. ▪ Basic customs duty on imported SUVs worth over $40,000 (3,000cc or more for petrol, 2,500cc or more for diesel) raised from 60% to 75% ▪ Customs duty on high-purity gold in various forms doubled

Impact of Budget on Investors

Positive	Negative
▪ Securities transaction tax on delivery-based deals reduced to 0.1% ▪ More options for investing in tax-free bonds (like NHAI and Hudco)	▪ TDS mandatory for sale of immovable property of over Rs 50L in urban areas and Rs 20L in rural areas ▪ 1% tax to be collected at source by seller for any sale in cash valued over Rs 2L of jewellery, bullion, etc ▪ TDS for interest from debentures if amount exceeds Rs 5,000 ▪ No tax sops for new life insurance policies with annual premium over 10% of sum assured (currently 20%) excluding loyalty bonus

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Impact of Budget on Businessmen

Positive	Negative
▪ Withholding tax on interest on ECBs reduced from 20% to 5% for power, airlines, roads etc for 3 years ▪ A year's extension for exemption under section 80IA for power firms; also for lower tax on overseas dividend ▪ Small service provider exemption increased from Rs 10L to Rs 50L	▪ Alternate Minimum Tax now on partnerships, sole proprietorships too ▪ All foreign assets must be declared Penalty up to 90% on undisclosed income found during search ▪ I-T Act amended retrospectively to tax 'offshore M&A deals' involving transfer of assets in India (such as Hutch-Vodafone transaction)

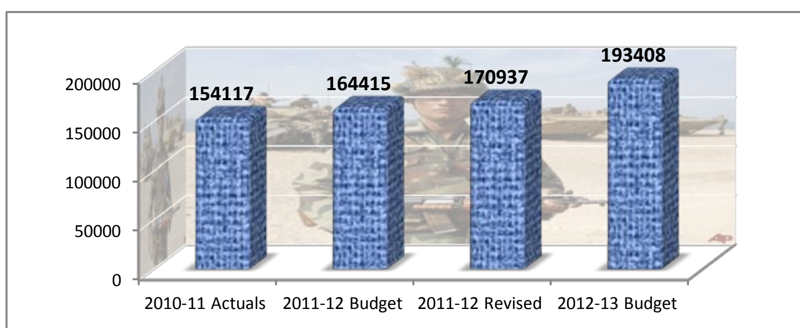
Proposals on Black Money

- In the Budget, the Government has announced a slew of measures to prevent generation and circulation of black money and to make it more difficult to stash undeclared income abroad. Minister said that he planned to introduce a white paper on black money in the current session of Parliament.
- The government plans to amend Section 149 of the Income Tax Act to allow for reopening of I-T return filings up to 16 years, from six years now. This amendment is expected to come into effect from July 1, 2012. Under the current provisions, the time limit is 6 years but tax authorities say it takes much longer to gather information on assets located outside India.
- The budget also makes proposals to make filing of I-T returns mandatory for every resident having any asset located outside India (including financial interest in any entity) or signing authority in any foreign account. Furnishing of return would be mandatory irrespective of whether the resident taxpayer has taxable income or not," the finance bill says. This amendment will take effect from April 1, 2012, and will apply to the 2012-13 and subsequent assessment years.
- In order to curb the practice of laundering money by taking advantage of the basic exemption limit, the finance bill proposes to levy a 30% tax on unexplained credit, money, investments and expenditure that is deemed as income under Sections 68, 69A, 69B, 69C or 69D.
- This levy will be irrespective of the slab of income. "No deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of the Act in computing income under the said sections," the finance bill said.

The government also plans to strengthen the penal provisions on undisclosed income found during a search. It plans to expedite prosecution proceedings under the IT Act. The finance bill also said that share premium in excess of the fair market value would be treated as income and this amendment would come into effect from April **2013.**

On Armed Forces

The budget says that modernization of the armed forces will continue in a steady with the defence outlay being hiked to Rs 1,93,408 crore (around $39 billion) to cater to some major fighter, aircraft, helicopter and howitzer deals in the coming fiscal.



There seems to be two major worries on Defense front. One is that India's budgeted defence expenditure still remains just 1.9% of the projected GDP for 2012-13. This fraction is much less than the 3% being demanded by the

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armed forces and strategic experts for several years to deter both China and Pakistan. Its worth note that China recently hiked its defence budget to over $100 billion.

Second worry is that the revenue expenditure (day-to-day costs and salaries) pegged at Rs 1,13,829 crore for the coming fiscal continues to far outstrip the capital one for new weapons, sensors and platforms at Rs 79,579 crore. The following table shows it:

Item	2010-11Actuals	2011-12 Budget	2011-12 Revised	2012-13 Budget
Revenue Expenditure on Defense	92061	95216	104793	113829
Capital Expenditure on Defense	62056	69199	66144	79579
Total	154117	164415	170937	193408

We are unable to find an answer of the question, how they are going to transform the armed forces without a substantial capital expenditure, though capital expenditure has registered a more robust 20.3% hike from last year's revised estimate of Rs 66,144 crore. This will only be enough to keep the modernization on track, without any surges, since a major chunk of it will also go for already contracted weapon systems. The biggest is the $20 billion deal to acquire 126 multi-role fighters for IAF. The final negotiations are now in progress for the French Rafale jet. IAF is also waiting for the Rs 3,000 crore deal for 75 Swiss Pilatus PC-7 turbo-prop trainers, and the Army is desperate to acquire 145 M-777 ultralight howitzers from the US for $647 million, its first-ever acquisition of 155mm guns since the infamous scandal in the mid-1980s derailed its artillery modernization plans.

Then, the budget documents show that the defence ministry has been forced to return Rs 3,055 crore of unspent capital funds. The 2012-2013 defence outlay represents a 17.63% hike over last year's allocation of Rs 1,64,415 crore. But if revised estimates of 2011-2012 are taken, it is a mere 13.14% jump.

On amendments to Fiscal Responsibility and Budget Management Act

In the Budget proposals, the government has introduced amendments to the Fiscal Responsibility and Budget Management Act as part of its effort to restore the health of public finances. The Implementation of the FRBM Act, 2003, at the Centre and the corresponding Acts at the state level contributed significantly to the government's fiscal consolidation efforts before the outbreak of the financial crisis. The outbreak of the crisis coincided with the year when the mandated targets of 3% fiscal deficit and elimination of revenue deficit were to be achieved. The government had to deviate from these targets due to the injection of fiscal stimulus at that time. Government also intends to use the Effective revenue deficit as a fiscal parameter. Effective revenue deficit is the difference between revenue deficit and grants for creation of capital assets. Focussing on this will help in reducing the consumptive component of revenue deficit and create space for increased capital spending.

On ISRO's Mars Mission

In the latest Budget, the allocation for Indian Space Research Organization's Mars Mission has rocketed to Rs 125 crore from Rs 10 crore. The overall budget for ISRO has shot up from Rs 4,432 crore to Rs 6,715 crore with several other planned projects. The allocation for the human space flight programme has increased from Rs 10 crore to nearly 30 crore. The Mars mission envisages launching an orbiter around the Red Planet in November 2013.

On Infrastructure Funding

In the latest budget, the Financial institutions and other lenders have been allowed to raise about Rs 60,000 crore from tax-free bonds in 2012-13, which is double that of last fiscal. This indicates that the focus of the Government is on infusing a heavy dose of funding in infrastructure. Out of the Rs. 60 thousand Crore, NHAI, Indian Railway Finance Corporation, India Infrastructure Finance Company Ltd and the power sector will get Rs 10,000 crore each. Hudco, National Housing Bank, SIDBI and ports will get Rs 5,000 crore each. The minister also mentions that investment in the

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infrastructure sector will go up to Rs 50 lakh crore during the 12th Five-Year Plan (2012-17), about half of which is expected from the private sector.

It's worth note that total investment in infrastructure has increased from 5.7% of GDP in 2007 to around 8.0% in 2011. This year's Budget aims for an increased growth rate between 9% and 10% with the fund-allocation of Rs 10,000 crore on developing the national highways alone. The increased allocation for roads will lead to a higher demand for bitumen, which refiners like us will benefit from.

On Disinvestment

This year, the government has lowered its disinvestment ambition, budgeting to raise Rs 30,000 through stake sale in public sector companies in 2012-13, compared to the Rs 40,000 target for the last fiscal year. This is a clear cut of 25%. The problem was that this year, the government could mop up only Rs 14,000 crore through stake sale in ONGC (Rs 13,100 crore) and Power Finance Corporation (Rs 1,100 crore). The analysts had expressed views last year that the target of Rs. 40,000 Crore would be sort of unachievable. However, government did not pay attention to them. This year, the target of Rs. 30 K Crore also seems to be a highly ambitious given that the government has at best managed to generate around Rs 23,553 crore during 2009-10 when it sold shares in NTPC, National Mineral Development Corporation, Oil India, National Hydel Power Corporation and Rural Electrification Corporation.

On Agriculture

Minister has tried to play Santa for this sector this year, as he increased allocation under this head by 18% to Rs 20,208 crore, enhanced interest subvention for farmers paying their loans on time by 3%, and promised greater commitment to allied areas like building storage and irrigation facilities. Buoyed with the results of last few years investments in the eastern India, such as additional paddy production of seven million tonnes in the kharif season of 2011,Minister has allocated an extra Rs 600 crore on the second Green India mission, taking it to Rs 1,000 crore for 2012-13. He also provides relief for farmers who borrow from the formal sector. The interest subvention scheme for shortterm crop loans to farmers at 7% interest per annum was extended by a year and an additional subvention of 3% was offered for timely repayment of loans. Post-harvest loans will also get 3% interest subvention against negotiable warehouse receipts.

The minister made an important announcement that existing schemes on raising agricultural productivity would be reworked in mission mode under the 12th five-year plan. These include the National Food Security Mission, National Mission on Sustainable Agriculture including Micro Irrigation, National Mission on Oilseeds and Oil Palm, National Mission on Agricultural Extension and Technology, National Horticulture Mission and a World Bank-supported, Rs 2,242-crore National Mission for Protein Supplement.

Minister also announced that viability gap funding under the Scheme for Support to PPP in infrastructure to attract private investment would be extended to irrigation, terminal markets, common infrastructure in agriculture markets and capital investment in fertilizer sector. Further, a National Mission on Food Processing was also launched. It will be carried out in tandem with state governments, pushing for greater value addition to the sector.

On Food Subsidy

The Government does not see the National Food Security Bill (NFSB) rolling out in the current fiscal year. So, the food subsidy has been increased marginally tjis year by Rs. 2,177 crore for the year 2012-13 from the revised estimate of Rs 72,823 crore in the previous year. The budgeted food subsidy last year was Rs 60,572 crore. While the revised allocation for this year too is expected to rise, the increase of about Rs 15,000 crore from the previous year's budgeted provision suggests that UPA's big ticket scheme is likely to roll out only in 2013-14, though the finance minister assured that he would fully support NFSB even as the government keeps the overall subsidy bill under 2% of GDP.

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For MSME

The Government has announced a Rs 5,000 crore venture fund for micro, small and medium enterprises (MSMEs) with SIDBI to enhance availability of equity to these units.The idea is to address the problems of access to affordable credit to the MSME sector as a majority of the units are unorganized and financial institutions are reluctant to lend to it in the absence of collaterals. Its worth note that two SME exchanges have been launched in Mumbai recently to enable these enterprises greater access to finance. The government has also approved a policy which requires ministries and central PSUs to make a minimum of 20% of their annual purchases from MSEs with the aim to promote market access to the sector, which is a major employer in the country. Of this, 4% will be earmarked for procurement from MSMEs owned by SC/ST entrepreneurs. Among other measures, the turnover limit for compulsory tax audit of accounts as well as for presumptive taxation is proposed to be raised from Rs 60 lakh to Rs 1 crore for MSMEs. The FM also proposed to exempt capital gains tax on sale of a residential property, if the sale consideration is used for subscription in equity of a manufacturing MSME company for purchase of new plant and machinery.

On Performance Related Incentive Scheme (PRIS)

The Government is planning performance-based incentives for its employees to bring its work structures more in line with the modern principle of incentive-based performance. Under the Performance Related Incentive Scheme (PRIS), the monetary incentive will be over and above an employee's regular salary and will be based on his performance in a given period. All that remains now is to work out the guidelines. According to the proposal, a 20% hike is envisaged for the best performing departments over and above the sixth pay commission payouts.

The Assets of the Government

As per the budget documents, the government owns Rs 8.66 lakh crore worth of assets — about Rs 2 lakh crore of which is physical property like buildings, roads, bridges and machinery. The remaining Rs 6.66 lakh crore comprises financial assets — equity shares, loans and other investments. Central government acquired physical assets worth Rs 21,879 and financial assets worth Rs 86,362 during 2010-11. The bulk of value of government's physical assets derives from land, valued at over Rs 1.2 lakh crore. Office and residential buildings owned by the government are valued at Rs 31,000 crore. The government also owns vehicles worth nearly Rs 2,400 crore and office equipment worth Rs 1,841 crore. The major assets of the Government is the loans and advances worth Rs 2.29 lakh crore given out by the central government to state and union territory governments, companies and foreign governments. Over Rs 1.3 lakh crore is the cumulative investment by the government in the railways.

On India's First Census Lab

India is ready to launch its first Census Lab that would allow sophisticated analysis to assess the state of the nation along with plausible reasons. The lab would allow policymakers and researchers to determine the root causes of socio-economic problems, such as unemployment and poverty, by drawing linkages between census findings about the population with household conditions—a correlation that has been impossible to make till now. This new policy tool would start being used from 2013-14 onwards. Census Lab would enable the finance minister to direct the government's social sector largesse more effectively than the current system of throwing money indiscriminately into welfare schemes. The first Census 'work-station' is expected to start in JNU soon, with the land mine of census data being opened up for statistical analysis. Unlike India's statistical machinery which puts out several sets of data on subjects like consumption expenditure and employment, these census would be based on sample surveys. The census is the only exercise that captures the entire population's status, allowing in-depth analysis.

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Chapter 12: Direct Tax Code

The Government had signalled its intention to consolidate and comprehensively amend the existing Income Tax Act 1961 and Wealth Tax Act 1957 through a single legislation, by releasing a draft Direct Taxes Code (DTC) and a discussion paper for public comments in August 2009. Based on analysis of the numerous inputs received from stakeholders, a revised discussion paper was released in June 2010 followed by the introduction of the **Direct Taxes Code Bill 2010** in Parliament in August 2010. It was first proposed to make it effective from 1 April 2012. However, Government has received the Report of the Parliamentary Standing Committee on March 9, 2012.

In the budget Government said that it will examine the report expeditiously and take steps for the enactment of DTC at the earliest.

The Direct Taxes Code Bill, 2010 introduced in Parliament, seeks to consolidate and amend the laws relating to all direct taxes, which are **income-tax, dividend distribution tax, and wealth tax** so as to establish an economically efficient, effective, and equitable direct tax system which will facilitate voluntary compliance and help increase the tax to GDP ratio. The salient features of the DTC are :

- It consolidates and integrates all direct tax laws and replaces both the Income Tax Act 1961 and the Wealth Tax Act 1957 with a single legislation.
- Simplification of the language so that even a layman can understand.
- Indication of stability in direct tax rates. At present the tax slabs are stipulated every year. Under the Direct Tax Code, the rates of taxes are to be prescribed in the Schedules of the code and thus the annual financial bill is not required to mention the tax rates again and again.
- The **Direct Tax Code proposes a corporate tax rate of 30 per cent against the current effective rate of 33.2 per cent** and raises the exemption limit as well as broadens the tax slabs for personal income tax.

Transfer Price Issue in DTC

The Direct Tax Code bill strengthens taxation provisions for international transactions. The bill proposes to enshrine the Advance Pricing Agreements for International Transactions which shall bring in certainty in transfer-pricing issues as any taxpayer can enter into an agreement with the tax administration, which will be valid for a period up to five years, regarding the manner in which the taxpayer would compute arm's length price in respect of the taxpayer's international transactions.

What is Transfer Pricing?

(Source: income tax website) *Commercial transactions between the different parts of the multinational groups may not be subject to the same market forces shaping relations between the two independent firms. One party transfers to another goods or services, for a price. That price is known as "transfer price". This may be arbitrary and dictated, with no relation to cost and added value, diverge from the market forces. Transfer price is, thus, a price which represents the value of good; or services between independently operating units of an organization. But, the expression "transfer pricing" generally refers to prices of transactions between associated enterprises which may take place under conditions differing from those taking place between independent enterprises. It refers to the value attached to transfers of goods, services and technology between related entities. It also refers to the value attached to transfers between unrelated parties which are controlled by a common entity.*

Suppose a company A purchases goods for 100 rupees and sells it to its associated company B in another country for 200 rupees, who in turn sells in the open market for 400 rupees. Had A sold it direct, it would have made a profit of 300 rupees. But by routing it through B, it restricted it to 100 rupees, permitting B to appropriate the balance. The transaction between A and B is arranged and not governed by market forces. The profit of 200 rupees is, thereby, shifted to the country

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of B. The goods is transferred on a price (transfer price) which is arbitrary or dictated (200 hundred rupees), but not on the market price (400 rupees).

Thus, the effect of transfer pricing is that the parent company or a specific subsidiary tends to produce insufficient taxable income or excessive loss on a transaction. For instance, profits accruing to the parent can be increased by setting high transfer prices to siphon profits from subsidiaries domiciled in high tax countries, and low transfer prices to move profits to subsidiaries located in low tax jurisdiction. As an example of this, a group which manufacture products in a high tax countries may decide to sell them at a low profit to its affiliate sales company based in a tax haven country. That company would in turn sell the product at an arm's length price and the resulting (inflated) profit would be subject to little or no tax in that country. The result is revenue loss and also a drain on foreign exchange reserves.

The Transfer pricing has been a taxing issue for both multinational corporations and tax authorities for a long time. The Transfer Pricing has been under tough scrutiny by the authorities in India, which look for a better share in the tax from the companies. Most of the countries in the western world have thier own rules regarding the transfer pricing. Indian Government also seels to take some proactive measures to resolve the disputes arising due to the transfer pricing.

The introduction of advance pricing agreement (APA) in the area of transfer pricing is a part of the Direct Taxes Code. The APA would be an advance agreement between the taxpayer and tax authorities that agrees to the pricing of goods or services between related parties such as companies and subsidiaries. This ruling would be binding to the tax payers and the taxing authorities. As per the DTC Bill, such arrangement would be valid for five financial years and would continue to be valid during that period, on the basis that the facts and conditions, based on which the rulings have been passed have not undergone a change.

Issue of Controlled Foreign Company Regulations (CFC) in DTC

The proposed bill seeks to align the concept of residence (of a company) by introduction of concept of "place of effective management" in India's tax treaties.

In the earlier draft of the DTC, it was proposed that the definition of companies liable to tax in India be extended to companies whose control or management was wholly or partly in India. It was widely criticized and the thus the new bill puts forward a new proposal which says that the companies whose board meetings and important commercial decisions are taken outside would not be considered taxable in India. This is called the "Controlled Foreign Company Regulations".

What is a CFC?

Controlled Foreign Company are those corporate entities which are incorporated and conducting business in an overseas low-tax jurisdictions, independent of the residency of the controlling owners. The problem with the CFC is the tax evasion. The CFCs earn incomes in the form of royalty, interest, rent and dividend but such income is sheltered by a low rate of tax and the income so generated is not distributed to the shareholders, leading to its deferral in the domestic high-tax jurisdictions.

Many countries have placed the CFC regulations so that thier residents can be prevented from reducing their tax liabilities by diverting profits to foreign companies they control and are situated in low-tax jurisdictions. The Direct Tax Code aims to empower the authorities to tax "passive income" earned by a foreign company controlled directly or indirectly by a resident in India, and where such income is not distributed to shareholders resulting in deferral of taxes. Such passive income shall be deemed to have been distributed and, consequently, would be taxable in India in the hands of resident shareholders, as deemed dividend received from the foreign company.

Branch Profit Tax on Foreign Companies in DTC

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At present the foreign companies are taxed at the rate of 42.2 per cent (inclusive of surcharge and cess) while domestic companies are taxed at the rate of 33.2 per cent (inclusive of surcharge and cess) plus a dividend distribution tax at the rate of 16.6 per cent when they distribute dividend from accumulated profits. The **Direct Tax Code** proposes to equate the tax rate of foreign companies with that of domestic companies by prescribing the rate at 30 per cent and levying a branch profit tax (in lieu of dividend distribution tax) at the rate of 15 per cent. The objective is that it will provide tax neutrality between a branch and a subsidiary of a foreign company in India.

Inclusion of Assets abroad under Tax

The Direct Tax Code bill proposes to include certain assets of residents which are held abroad, such as deposits in bank accounts in the case of individuals and interest in a foreign trust or in a controlled foreign corporation. This will create a reporting requirement mechanism for assets held abroad.

Other Provisions of DTC

- The DTC proposes to phase out **Profit-linked Tax Incentives** and **Replacing them by Investment-linked Incentives**. This is mainly because the profit-linked deductions are inherently discriminatory, prone to misuse by shifting of profits from non-exempt to exempt entity or by reporting higher profits in exempt income entity, and also lead to high level of litigation and revenue foregone. They also impede the Government's efforts to give a moderate tax rate to other taxpayers as the higher taxes paid by others by implication cross-subsidize the lower tax rates of the profit-linked deduction sectors. Such profit-linked deductions are being phased out of the Income Tax Act and have also been dropped in the DTC. They are being replaced by investment-linked deductions for specified sectors. Investment-linked incentives are calibrated to the levels of creation of productive capacity and therefore are superior instruments. Profit-linked deductions currently being availed of have been protected for the unexpired period in the DTC.
- The DTC proposes to rationalize the Tax Incentives for Savings in order to focus savings incentives on long-term savings for social security of the taxpayer during his non-working life. The bill proposes a deduction of up to Rs 1 lakh has been provided for investments in approved provident funds, superannuation funds, and pension funds.

Chapter 13: Finance Commission

We know that under the provisions of article 280 of the constitution of India,. The President of India is required to appoint a finance commission for the purpose of development of **non-plan revenue resources**.

Why Finance Commission?

In India, resource transfers from the Centre to states, comprising **statutory and non-statutory transfers** take place through a multiplicity of channels. **Statutory transfers in the form of share in central taxes** and **non-plan grants are based on the recommendations of the Finance Commissions.** Non-statutory revenue transfers are in the form of plan grants from the Planning Commission, as well as plan and non-plan grants from the central ministries.

The Finance commission makes the following recommendations **to the President**

- Distribution of the net proceeds of the taxes to be shared between the Union and the states and allocation of the share of such proceeds along the states.
- Principles which should govern the payment of grant-in aids by the Union to the revenues of the states.
- Any other matters related to the financial relations between the Union and the state Governments.
- Thus we see, that the appointment of the Finance commission is very important. The President has till now appointed 13 Finance Commissions. Before we move to the recommendations of the 13th Finance commission, some important points which must be noted regarding the first 12 Finance Commissions.

Percentage of allocation

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- It was the First Finance commission under J P Neogi, which recommended that the States should share 55% of the proceeds of income tax. But the successive finance commission raised the share of the state Governments to 85% , for example 7th and 9th FCs.
- The Tenth Finance Commission recommended the 77.5% share of the net proceeds of the taxes on the income to be assigned to the states.

Division of allocation

- The initial finance commissions used the dual criteria of "population" and "collection" for division of the proceeds among the states. The JP Neogi commission said that the allocation of the income taxes should be on the basis of 80% on population and 20% on collection. Thus the states with large population got benefitted. But the second Finance Commission went a step ahead and said that the income tax should be allocated as 90% on the basis of the population and 10% on collection.
- The states like Uttar Pradesh and Bihar got benefits of this arrangement which were poor but were home to a large population. In contrary , the states like Maharastra and Gujarat had large collection compared to their populations. So somehow it was not justified by these states.
- The situation was once reverse by the third finance commission and again it made the division on the basis of 80:20 in the ratio of population and collection.
- The same criteria followed for many decades. It was the **Eighth Finance Commission (Y B Chavan)** which gave a new formula for the first time for division of the income taxes. As per this new formula
  - 10% to be continued on the basis of collection of income tax.
  - 90% of the proceeds should be distributed as follows:
    - 25% Population basis
    - 25 % on the basis of inverse of Percapita population of the state multiplied by population.
    - 50 % on the basis of distance of the Percapita income of the state from the highest Percapita income state (Punjab) in the country and multiplied by population of the state.

- Thus we see, that the 8th finance commission tried to bring high equality among the states by introducing a **3 Factor Formula.**

✍ After that it was the 10th Finance commission which presented the following formula:

- 20% on the basis of population of 1971
- 60% on the basis of distance of Percapita income of the state from the state having highest Percapita income.
  - 5% on the basis of area adjusted.
  - 5% on the basis of infrastructure.
  - 10% on the basis of Tax Efforts.

Whatever may be the formula, the successive Finance Commissions except the 10th finance commission. The information about the first 10 Finance Commissions is briefed in the following table:

No.	Estd.	Chairman	Operation Years	Recommendation on Income Tax		
				State Share	Population Criteria	Collection Criteria
I	1951	K C Niyogi	1952-57	55	80	20
II	1956	K Santhanam	1957-62	60	90	10
III	1960	A K Chanda	1962-66	65	80	20
IV	1964	P V Rajamannar	1966-69	75	80	20
V	1968	Mahaveer Tyagi	1969-74	75	90	10
VI	1972	B N Reddy	1974-79	80	90	10
VII	1977	J M Shellet	1979-84	85	90	10
VIII	1983	Y B Chavan	1984-89	85	90	10
IX	1992	N K P Salve	1989-95	85	90	10
X	1998	K C Pant	1995-2000	77.5	20	80

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The above distribution is of the Income Tax. Next comes the excise duties. The first Finance Commission had selected three excise duties on tobacco, matches and vegetable products for division with the states. It recommended that 40% of the net proceeds of these duties to be distributed among the states on the basis of the population. The second finance commission reduced this to 25% , but increased the number of the duties to 8. The Third finance commission further reduced the share to 20% but the number of the excisable commodities in the divisible pool was increased from 8 to 35. The following table summarizes the recommendations of the 10 Finance Commissions in terms of the share of the states in the excisable commodities and divisible pool of the collected proceeds.

Finance Commission	States Share of Excise Duty
I	40% of 3 duties
II	25% of 8 duties
III	20% of 35 duties
IV	20% of 45 duties
V	20% of 45 duties
VI	20% of 45 duties
VII	40% (of all duties)
VIII	45% (of all Duties)
IX	45 % of all duties
X	47.5% of all duties.

Grant-in-aid to the States

The State list of the 7th schedule entrusts the important welfare and development functions to the State Governments. But it was found that the tax resources of the state Governments were inadequate, so the constitution provides a mechanism of the grant-in-aid from the centre to the states which may be used to

- ✓ Overcome the current revenue deficits of the states
- ✓ Correct the interstate disparities
- ✓ Specific purposes such as promotion of resources etc.

This means that every Finance commission makes recommendation to the President of India on the basis of the conditions prevalent in the country at that time as well as the policies of the state Governments. For example the First finance commission recommended the grant-in-aid for 7 states to cover their deficits in the budgets and 8 states to improve their primary education facilities. Similarly the third finance commission recommended the grant-in-aid of ₹ 550 crore for the states (except Maharastra) to cover the part of their revenue expenditure.

The Ninth Finance commission also provided grant-in-aid for a Calamity Relief Fund for the first time to some states, as Centre's contribution.

Loans to State Governments

During the first plan, the loans of the state government kept mounting. It was the second Finance Commission which was urged to look into this matter and this commission came out with the recommendations that the states should be entitled to only two loans in a year viz. 1 long term and 1 medium term. The rate of the interest should be almost equal to the rate of interest on which the central Government is borrowing from the market. Next problem was of overdrafts. It was seen that the states indulged excessively against the fiscal discipline and the 5th finance commission advised that the states should balance their budgets within the resources available to them and refrain from the overdrafts. The successive finance commissions have been suggesting measures for the states to keep their fiscals in discipline.

12th Finance Commission

12th Finance commission, appointed in 2002 was headed by Dr. C Rangarajan. The commission submitted its report in 2005 and all the recommendations of the 12th Finance Commission were accepted.

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- It recommended that the present system of the Central assistance to the states in the forms of the grants and loans and recommended that they should be "linked to the Fiscal reforms".
- The 12th Finance Commission used the following criteria and weights for determination of the shares of the states

Population :	25.0%
Income Distance :	50%
Area:	10%
Tax Effort	7.5%
Fiscal Discipline	7.5%

The TFC raised the share of States in shareable Central taxes from 29.5 per cent to 30.5 per cent. Total transfers to States recommended by the TFC amount to ₹ 7,55,752 crore over the five year period 2005-10. Of this, transfers by way of share in Central taxes and grants-in-aid amount to ₹ 6,13,112 crore and ₹ 1,42,640 crore, respectively. The total transfers recommended by the TFC are higher by 73.8 per cent over those recommended by the Eleventh Finance Commission (EFC). Within the total transfers, while the share in Central taxes is higher by 62.9 per cent, grants-in aid recommended by the TFC is higher by 143.5 per cent over those recommended by the EFC.

Some important recommendations: (Source Economic Survey 2004-5)

Restructuring public finances

- ✓ Centre and States to improve the combined tax-GDP ratio to 17.6 per cent by 2009-10.
- ✓ Combined debt-GDP ratio, with external debt measured at historical exchange rates, to be brought down to 75 per cent by 2009-10.
- ✓ Fiscal deficit to GDP targets for the Centre and States to be fixed at 3 per cent.
- ✓ Revenue deficit of the Centre and States to be brought down to zero by 2008-09.
- ✓ Interest payments relative to revenue receipts to be brought down to 28 per cent and 15 per cent in the case of the Centre and States, respectively.
- ✓ States to follow a recruitment policy in a manner so that the total salary bill, relative to revenue expenditure, net of interest payments, does not exceed 35 per cent.
- ✓ Each State to enact a fiscal responsibility legislation providing for elimination of revenue deficit by 2008-09 and reducing fiscal deficit to 3 per cent of State Domestic Product.
- ✓ The system of on-lending to be brought to an end over time. The long term goal should be to bring down debt-GDP ratio to 28 per cent each for the Centre and the States.

Grants-in-aid to States

- ✓ The present system of Central assistance for State Plans, comprising grant and loan components, to be done away with, and the Centre should confine itself to extending plan grants and leaving it to States to decide their borrowings.
- ✓ Non-plan revenue deficit grant of Rs.56,856 crore recommended to 15 States for the period 2005-10. Grants amounting to Rs.10,172 crore recommended for the education sector to eight States. Grants amounting to Rs.5,887 crore recommended for the health sector for seven States. Grants to education and health sectors are additionalities over and above the normal expenditure to be incurred by States.
- ✓ A grant of Rs.15,000 crore recommended for roads and bridges, which is in addition to the normal expenditure of States
- ✓ Grants recommended for maintenance of public buildings, forests, heritage conservation and specific needs of States are Rs. 500 crore, Rs.1,000 crore, Rs.625 crore, and Rs.7,100 crore, respectively.

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Fiscal reform facility

- ✓ With the recommended scheme of debt relief in place, fiscal reform facility not to continue over the period 2005-10.

Debt relief and corrective measures

- ✓ Central loans to States contracted till March,2004 and outstanding on March 31, 2005 amounting to Rs.1,28,795 crore to be consolidated and rescheduled for a fresh term of 20 years, and an interest rate of 7.5 per cent to be charged on them. This is subject to enactment of fiscal responsibility legislation by a State.
- ✓ A debt write-off scheme linked to reduction of revenue deficit of States to be introduced. Under this scheme, repayments due from 2005-06 to 2009-10 on Central loans contracted up to March 31,2004 will be eligible for writeoff.
- ✓ Central Government not to act as an intermediary for future lending to States, except in the case of weak States, which are unable to raise funds from the market.
- ✓ External assistance to be transferred to States on the same terms and conditions as attached to such assistance by external funding agencies.
- ✓ All the States to set up sinking funds for amortization of all loans.
- ✓ States to set up guarantee redemption funds through earmarked guarantee fees.

Others

- ✓ The Centre should share 'profit petroleum' from New Exploration and Licensing Policy (NELP) areas in the ratio of 50:50 with States where mineral oil and natural gas are produced. No sharing of profits in respect of nomination fields and non-NELP blocks.
- ✓ Every State to set up a high level committee to monitor the utilization of grants recommended by the TFC (Tenth Finance Commission)
- ✓ Centre to gradually move towards accrual basis of accounting.

13th Finance Commission

The Government presented the 13th finance Commission (headed by Mr. Vijay Kelkar) report in the parliament on February 25, 2010. The report was submitted to the president on December 30, 2009. The major recommendations are discussed here:

Consistency in Accounts

- Ministry of Finance (MoF) should ensure that the **finance accounts fully reflect the collections under cesses and surcharges** as per the relevant heads, so that there **are no inconsistencies between the amounts released to states in any year** and the respective percentage shares in net central taxes recommended by the Finance Commission for that year.

The issue of Power Sector in States

- States need to address the problem **of losses in the power sector** in a time-bound manner. This is because of the fact that **the subsidy for the power sector is the largest component of State Government subsidies.** The report says that most of the State Power Utilities (SPUs) have negative financial flows. As SPUs are fully owned by State Governments, the financial performance of these entities has a direct bearing on state finances.

The Problem of too many CSS

- As noted above, the Statutory transfers in the form of share in central taxes and non-plan grants are based on the recommendations of the Finance Commissions. Non-statutory revenue transfers are in the form of plan grants from the Planning Commission, as well as plan and non-plan grants from the central ministries. The commission notes that the **plan grants have become more scheme-oriented**, **reverting in a way to the pre-1969 position** of scheme-based transfers. The Commission recommends that the number of Centrally Sponsored Schemes and

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moving towards predominance of formula-based transfers, but there has been no significant movement in this direction.

- There should be initiatives to reduce the number of Centrally Sponsored Schemes (CSS) and to restore the predominance of formula-based plan transfers.

Question: What is the difference between Central Sector Scheme and Centrally Sponsored Scheme?

This is a basic but important question. As we know that the Government of India is involved in a large number of programmes that are in the state list of the Constitution. So, when the Central Government launches such programmes **which are in the state list of the Constitution the responsibility of implementing these schemes is of the state Governments, they are called centrally Sponsored Schemes. The Union Government has no control over the staff, or over day-to-day supervision or coordination so necessary for the success of such schemes.**

- ✓ The number of such centrally sponsored scheme has increased post 1969 and now the number stands at around 220 (the figure is not exact).
- ✓ The result is that these schemes are poorly implemented.

However, its worth note that the Comptroller and Auditor General of India had done a study in 1999 and came out with some amazing find outs as follows:

1. States unwillingness to accept poor performance, for fear of being questioned by Parliament or adverse press publicity.
2. Since schemes are implemented by the states, the sensitivity associated with centre-state relations often precludes the centre from asking embarrassing questions.
3. Ministries are hesitant to monitor state sector schemes, although it may have important bearing on the sector with which the central Ministry is concerned. Capacity to do effective monitoring is limited, and often does not exist.
4. Most schemes follow a blue print and top-down approach, with little flexibility given to field staff.
5. Any change in the scheme requires approval from GOI which is time consuming.
6. Uniformity of schemes all over the country without sufficient delegation to states to change the schemes to suit local conditions, leads to a situation where the states even knowing that the scheme is not doing well become indifferent to its implementation.

That is why the 13th Finance Commission recommends that the number of CSS should go down and predominance of formula-based plan transfers should be there.

Fiscal Discipline:

The 13th FC recommended that a calibrated exit strategy from the expansionary fiscal stance of 2008-09 and 2009-10 should be the main agenda of the Centre.

- ✓ The centre should target a revenue surplus by 2014-15
- ✓ Combined debt of the Centre and States should be capped at 68% of the GDP by March 2015. It was 82% when the report was presented.
- ✓ The report recommends that in case of the macroeconomic shocks, the centre should borrow and devolve the states instead of relaxing the borrowing limits of the states.

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The Finance commission had laid down a fiscal roadmap of the Centre and for states. The following table shows this path for the Centre:

Item	% of GDP				
	2010-11	2011-12	2012-13	2013-14	2014-15
Revenue Deficit	3.2	2.3	1.2	0.0	-0.5
Fiscal Deficit	5.7	4.8	4.2	3.0	3.0
Non-debt capital receipts	0.5	0.6	0.8	0.9	1.0
Capital expenditure	3.0	3.1	3.8	3.9	4.5
Outstanding debt	53.9	52.5	50.5	47.5	44.8

The above table makes it clear that the 13th FC wants the central Government to be revenue surplus by 2014-15 and control the Fiscal deficit to 3.0% of the GDP.

Why the 13th FC wants more disinvestments and proceeds to be placed in Consolidated Fund of India?

Regarding Capital Expenditure, the 13th Finance Commission recommends a growth to 4.5% of the GDP. Here, an important implication comes out. The 13th Finance Commission says that the capital expenditure involves a 'sacrifice' of present consumption by the present generation and thus, the future generations have an obligation to repay this sacrifice. So the Commission says that the disinvestment increases non-debt capital receipts and so, ceteris paribus, allows the government to increase its capital expenditure without impacting the fiscal deficit. That is why the commission recommends that the *transfer of disinvestment receipts to the public account, as has been the practice in the past, be discontinued and that all disinvestment receipts be maintained in the consolidated fund*, (which would help fiscal consolidation of the country).

Share of States

The 13th FC has recommended higher transfers of Central taxes and Finance Commission grants to be provided by the Centre to the States as compared with what the Twelfth Finance Commission had advised.

- ✓ The 13th FC has recommended that the share of the States in the net proceeds of Central tax collections be fixed at 32% over the 13th FC's award period, higher than the share of 30.5% that had been set by the 12th FC for the award period 2005-06 to 2009-10.
- ✓ Additionally, the total grant of ₹ 3,185810 Crore to be provided by the Centre to the State Governments over the 13th FC award period is more than twice the amount recommended by the 12th FC.
- ✓ The 13th FC's recommendations on Central tax devolution and grants would serve to reduce the vertical imbalance between the Centre and the States and are a positive from the point of view of fiscal federalism.

Criteria and Weight for Tax Devolution

This is an important point. The 13th FC and the 13th FC show a basic divergence from the creatria and weights for the Tax devolution. The following table shows the criteria used both of them (tables are located on page 131 of 12th FC and Page 123 of 13th FC reports respectively)

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12th Finance Commission	13th Finance Commission

Table 7. 2

Criteria and Weights

Criteria	Weight (per cent)
Population	25.0
Income Distance	50.0
Area	10.0
Tax Effort	7.5
Fiscal Discipline	7.5

Table 8.1: Criteria and Weights for Tax Devolution

(per cent)

Criteria	Weight
1. Population (1971)	25.0
2. Area	10.0
3. Fiscal Capacity Distance	47.5
4. Fiscal Discipline	17.5

- The above table shows very clearly that the 13th Finance Commission gives 2.5 times more weightage to the Fiscal Discipline of the states in deciding the Tax devolution.

Here is an explanation to this shift:

The Fiscal discipline was used by both the 11th Finance Commission as well as the 12th Finance Commission to provide an incentive to those states which manage their finances prudently. Both these Commissions assigned a weight of 7.5 per cent to this criterion. The 13th FC belived that there is a strong case to incentivise states following fiscal prudence, particularly in the context of the need to return to the path of fiscal correction. So, the 13th FC assigned a weight of 17.5 per cent to fiscal discipline.

What if the states are not able to improve the fiscal position?

The 13th FC says that if all states have improved their respective ratios of own revenue to total revenue expenditure, then the states with relatively higher improvement than the average receive higher transfers, and if the ratio has deteriorated in all states, then too states with lower deterioration than the average receive higher transfers.

Regarding Service Tax:

- **In India, the service tax is not levied in the state of Jammu & Kashmir.**

Therefore, net proceeds of service tax are not assignable to this state. The FC recommends that if any tax of the Union is not leviable in a state, the share of that state in the tax should be treated as zero and the entire proceeds of that Union tax should be distributed among the remaining states by proportionately adjusting their shares.

Chapter 14: Good and Services Tax

The first thing about GST is that it's a comprehensive indirect tax which is to be levied on the manufacture, sale and consumption of goods and services at a national level.

- Since, the state Government have vested interests in GST, the implementation of GST cannot take place without amendment of the Indian Constitution

We all know that our country has a federal structure with a clear distinction in the Union and State functions and sources of their revenue.

The Constitution of India provides the residual powers to the Centre and article 264 & 293 are related to the financial relations between the Union and the State Governments.

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✓ Some taxes are levied and collected by the state Governments. Apart from that they also have a share in the tax proceeds of the central government, which are collected and levied by the Central Government.

The 13th Finance commission wanted the Government to target a single 12% GST against the cascading levels of 20.5 % ((8 per cent for CENVAT and 12.5 per cent for VAT) for the Centre and States Combined. The Uniform GST comprising a dual levy of 5% by the Centre and 7% by the States on a comprehensive base which is feasible. The Commission also recommends that all exemptions are removed and indirect taxes and cess be integrated into GST and tax is levied with systematic and logical integrity.

The 13th Finance Commission was required to consider "the impact of the proposed implementation of Goods and Services Tax with effect from 1st April 2010 (it was the first date decided for implementation of GST) including its impact on the country's foreign trade', while formulating its recommendations. The commission noted that this would be a game-changing tax reform measure which will significantly contribute to the buoyancy of tax revenues and acceleration of growth, as well as generate many positive externalities.

What are multiple tax incidences?

In the current system, there are multiple incidences on taxes and cascading impact on the cost of Finished Goods. We assume a supply chain which starts from the raw material and ends on the sale to the end customer, the following taxes are needed to be paid at various stages:

1. Custom Duty + Counter Veiling Duty + Cess paid on imported Goods if the Raw material is imported.
2. Sales Tax / VAT paid on domestic purchases, which includes the excise duty paid by the raw material manufacturer. Sales Tax /VAT is also charged on the excise duty element.
3. When the raw good are converted into manufactured goods, there is an excise duty on the cost of manufactured goods. So, this excise duty also gets levied on the sales tax element (or custom duty & cess for imported) paid on raw materials.
4. When the finished product is transported for delivery, there is a Service Tax on the Transportation
5. When the Finished goods are sold to the end users , there is Sales Tax (CST or VAT) on the sales of Finished Goods cost, which also includes the excise duty elements, sales tax paid on raw materials and service tax paid on transportation. Practically, the sales tax at this stage gets levied on all the taxes paid in the previous steps.

The problem of Interstate transport:

The goods when transported from one state to another state in India, there are different forms and permits needed. Some examples are as follows: (don't memorize)

1. **In Uttar Pradesh** : Form 31 required for goods moving into UP and for imports another form 49 is needed.
2. **In Rajasthan** : Form 18A & 18 B for incoming & outgoing goods. Form VAT 51 for the goods passing through state but not to be delivered in the state.
3. **In West Bengal :** Way bill 42 for incoming & 48 for outgoing goods. T.P. required for Transit goods.
4. **In Punjab :** S.T. form 24A for all incoming goods.
5. **In Orissa** : Orissa way bill no. 32 (XXXII) for incoming goods. T.P. required

The result of the above discrepancy is that the transporters & companies have to fill these forms for all the consignments, keep records & submit returns. The first problem is getting these forms as they are maintained in serial numbers. Second problem is of these forms to be presented as each of the check posts, if the trucker is not able to do so, the truck is detained. The checking of these documents itself is cumbersome so we can see long lines on the check posts. The result is a drastic increase in the transit time from the source to destination. It is said that in India, the

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transit time is 50% higher than other countries. The direct implication of this is the decrease in the return on investment per truck.

Background of Indirect taxes in India

The first phase of reform of indirect taxation occurred when the Modified Value Added Tax (MODVAT) was introduced for selected commodities at the central level in 1986, and then gradually extended to all commodities through Central Value Added Tax (CENVAT).

The introduction and integration of service tax into CENVAT deepened this effort. Reform at the state level occurred through introduction of Value Added Tax (VAT) by all the states in the country in a phased manner between April 2003 and January 2008 Buoyed by the success of VAT, and mindful of the need for further improvement, the Government of India (GoI) indicated in Feb 2007 that a roadmap for introduction of destination-based GST in the country by 1 April 2010 would be prepared in consultation with the Empowered Committee (EC) of state Finance Ministers. This commitment was reiterated in February 2008 and July 2009. The origin-based Central Sales Tax (CST) was successively reduced from 4 to 3 per cent and 2 per cent during 2007 and 2008, respectively, as part of this reform process. In November 2007, a Joint Working Group consisting of representatives of the Empowered Committee and the Government of India prepared a report on the changeover to GST. The report titled 'A Model and Road Map for Goods and

Service Tax in India', was released in 2008 and it recommended the dual GST Model in India. It was followed by 'First Discussion Paper on Goods and Service Tax in India' in November 2009. This discussion paper provides details of the taxes to be subsumed, while at the same time, outlining the modalities of implementation of the tax.

The GST Model:

The 13th Finance Commission report proposed a model GST , which would not distinguish between goods and services. It should be levied at a single positive rate on all goods and services. Exports should be zero-rated. Tax compliance costs should be low and tax credits should be available seamlessly across tax jurisdictions.

For the GST to be purely consumption based, all related indirect taxes and cesses should be subsumed into it. Thus, the Central GST portion would subsume the following taxes:

1. Central excise duty and additional excise duties
2. Service Tax
3. Additional Customs Duty (Countervailing Duty)
4. All surcharges and cesses

Similarly, the state GST would subsume the following taxes:

1. Value Added Tax
2. Central Sales Tax
3. Entry Tax, whether in lieu of octroi or otherwise
4. Luxury Tax
5. Taxes on lottery, betting and gambling
6. Entertainment Tax
7. Purchase Tax
8. State Excise Duties
9. Stamp Duty
10. Taxes on vehicles
11. Tax on goods and passengers

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12. Taxes and duties on electricity
13. All state cesses and surcharges

Features as per 13th Finance Commission Model

- In the GST system, both Central and State taxes are to be collected at the point of sale.
- Both components (the Central and State GST) will be charged on the taxable manufacturing cost.

- ✓ **Single 12% rate on all Goods and Services -** 5% for Central GST and 7% for State
- ✓ **Railway fares and freight, electricity to attract taxes.**
- ✓ The taxation of petroleum products and natural gas would be rationalised by including them in the tax base thus, they would be brought under GST.
- ✓ The Public services by the governments, service transactions between the employer and employee, health & education **to be exempted from GST**.
- ✓ **Exports will be Zero Rated.**
- ✓ Imports from outside the country would be subject to GST on the destination principle. This will require that proof of consumption at a predetermined destination state should be provided.
- ✓ Taxation burden will be divided equitably between manufacturing and services, through a lower tax rate by increasing the tax base and minimizing exemptions.
- ✓ GST will be is **levied only at the destination point, and not at various points** (from manufacturing to retail outlets).
- ✓ **All transactions across tax jurisdictions should be free from tax**. While exports will be zero rated, inter-state transactions should be effectively zero-rated so as to ensure that the tax is collected by the consuming state consistent with the destination principle.
- ✓ All stages of the taxation chain, from levy of the tax to its assessment, collection and appropriation, should be similar across states.
- ✓ It was estimated that India will gain $15 billion a year by implementing the Goods and Services Tax as it would promote exports, raise employment and boost growth. It will divide the tax burden equitably between manufacturing and services.

France was the first country to introduce GST system in 1954. Almost 140 countries have already implemented the GST. Most of the countries have a unified GST system. Brazil and Canada follow a dual system where GST is levied by both the Union and the State governments.

Concerns of the State Governments

Earlier some governments such as Madhya Pradesh, Chhattisgarh and Tamil Nadu said that the information technology systems and the administrative infrastructure will not be ready by April 2010 to implement GST. So, GST was shelved for first 1 year and now till April 1, 2013, which is still not a clear deadline.

The various state Governments have sought assurances that their existing revenues will be protected, fearing that if the uniform tax rate is lower than their existing rates, it will hit their tax kitty. The centre believes that dual GST will lead to better revenue collection for States. The 13th FC has recommended a compensation mechanism in case of the loss to the Government of states.

Regarding Constitutional Amendment

The biggest concern of the states is that Centre may unilaterally raise tax rates without consulting them and the Constitution does not envisage sharing of tax bases. **Taxation powers are listed either in the State List or in the Central List, but not in the Concurrent List.** For the first time since the Constitution was enacted, <u>a tax base is</u>

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proposed to be shared between the Centre and the states. It is, thus, necessary that a firm arrangement be put in place for implementing the GST to prevent deviations from the agreed upon model by either the Centre or the states.

Sweet deal for states: the Grand Bargain

To incentives implementation of the Grand Bargain between the states and the Centre, 13th Finance Commission recommended the sanction of a grant of Rs. 50,000 crore to be provided to all states in the aggregate, subject to the GST framework adopted being consistent with the Grand Bargain. Thus the central grant would help the states to meet the compensation claims. The 13th FC recognised that while GST on the whole will be revenue neutral, there may be some winners and losers during the initial years of implementation. This grant will accommodate claims for compensation from the adversely affected states and balance will be distributed amongst states as per the devolution forumula. Here is the path, showed by the 13th Finance Commission in this regard:

Table 5.2- Scheduling of GST Grant

2010-11	Rs. 5000 crore
2011-12	Rs. 11250 crore
2012-13	Rs. 11250 crore
2013-14	Rs. 11250 crore
2014-15	Rs. 11250 crore

Constitutional Amendment Important Points

- **Article 246A** to be introduced through Constitutional amendment that would give Parliament & state assemblies power to levy GST Constitution.
- Introducing **Article 279A** that will provide for creation of a GST council. The GST council is to be headed by Finance Minister and will have state Finance Ministers as members
- Article 279B to be introduced through Constitutional amendment making a provision for dispute settlement authority which shall consist of a chairperson and 2 members to be appointed by chief Justice .
- **GST to be defined under Article 366(12)A.**
- The above points have been agreed as of now.

Structure

1. An IT architecture with a common GST portal is envisaged and agreed upon.
2. All taxpayers will now directly pay tax with the GST portal, though the existing structures to be used for audit &enforcement issues
3. An special purpose vehicle (SPV) will be responsible for running the GST portal. State, Centre & a technology company will be partners in the SPV.

GST as quoted by FM in Budget 2011-12

- ✓ *The introduction of the Direct Taxes Code (DTC) and the proposed Goods and Services Tax (GST) will mark a watershed. These reforms will result in moderation of rates, simplification of laws and better compliance.*
- ✓ *Direct Taxes Code Bill was introduced in Parliament in August, 2010. After receiving the report of the Standing Committee, we shall be able to finalise the Code for its enactment during 2011-12. This has been a pioneering effort in participative legislation. The Code is proposed to be effective from April 1, 2012 to allow taxpayers, practitioners and administrators to fully understand the legislation and adjust to the revised procedures.*
- ✓ *Unlike DTC, decisions on the GST have to be taken in concert with the States with whom our dialogue has made considerable progress in the last four years. Areas of divergence have been narrowed. As a step towards the roll-out of GST,*

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I propose to introduce the Constitution Amendment Bill in this session of Parliament. Work is also underway on drafting of the model legislation for the Central and State GST.

- ✓ *Among the other steps that are being taken for the introduction of GST is the establishment of a strong IT infrastructure. We have made significant progress on the GST Network (GSTN). The key business processes of registration, returns and payments are in advanced stages of finalisation.*
- ✓ *The **National Securities Depository Limited (NSDL) has been selected as technology partner for incubating the National Information Utility that will establish and operate the IT backbone for GST.***
- ✓ *By June 2011, NSDL will set up a Pilot portal in collaboration with eleven States prior to its roll out across the country.*

GST as quoted by FM in Budget Speech 2012-13

Constitution Amendment Bill, a preparatory step in the implementation of Goods and Services Tax (GST) was introduced in Parliament in March 2011 and is before the Parliamentary Standing Committee. As we await recommendations of the Committee, drafting of model legislation for Centre and State GST in concert with States is under progress. The structure of GST Network (GSTN) has been approved by the Empowered Committee of State Finance Ministers. GSTN will be set up as a National Information Utility and will become operational by August 2012. The GSTN will implement common PAN-based registration, returns filing and payments processing for all States on a shared platform. The use of PAN as a common identifier in both direct and indirect taxes, will enhance transparency and check tax evasion. I solicit the support of all my colleagues cutting across party lines for an early passage of these landmark legislations.

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