Katalyst Kaleidoscope

February 2019: Interim Budget Special Issue

A. Background and Macro factors

Introduction

The year 2019 is the election year for India and whilst, usually, a vote on account budget is expected, an Interim Budget was presented with significant announcements and some amendments on the tax front, primarily addressing the rural economy/ agricultural economy, unorganized sector, MSME sector and the middle-class populace.

Macro-economic backdrop for Budget 2019

Although no Economic Survey was released since it was an Interim Budget, the speech of the stand-in Finance Minister outlined certain statistics intended to project the performance of the Government during its tenure since 2014, which is summarized as follows:

Macro-economic factors:

- The fiscal deficit has been brought down to 3.4% in FY 2018-19 with current account deficit being up to 2.5% of the GDP this year. However, as it can be seen, the fiscal deficit is still in excess of the limit of 3%, which is targeted to be achieved by 31 March 2021 under the Fiscal Management Principles laid down in the Fiscal Responsibility and Budget Management Act, 2003;
- The average inflation rate has been brought down to a single digit of 4.6% with the inflation in December 2018 being only 2.9% which falls within the targeted inflation band of 4% +/- 2%;
- GST collection has increased with an average monthly collection of INR 97,100 Crs in the current year as compared to INR 89,700 Crs in the first year of implementation;
- FDI inflows during the last 5 years amounting to USD 239 Billion were attracted;
- A gist of the revenue and deficit figures have been highlighted in the table below:

Budget at a Glance

(In ₹ crores)

	2017-2018 Actuals	2018-2019 Budget Estimates	2018-2019 Revised Estimates	2019-2020 Budget Estimates
1. Revenue Receipts	**14,50,000**	**17,00,000**	**17,50,000**	**20,00,000**
a. Tax Revenue	12,50,000	15,00,000	15,00,000	17,00,000
b. Non Tax Revenue	2,00,000	2,00,000	2,50,000	3,00,000
2. Capital Receipts (loan recovery)	7,00,000	7,10,000	7,25,000	8,00,000
3. Total Receipts	**21,50,000**	**24,10,000**	**24,75,000**	**27,84,200**
4. Total Expenditure	**22,00,000**	**24,00,000**	**24,50,000**	**28,00,000**
a. On Revenue Account	19,00,000	21,00,000	21,40,000	25,00,000
b. On Capital Account	3,00,000	3,00,000	3,10,000	3,00,000
9. Revenue Deficit	**4,50,000**	**4,00,000**	**4,00,000**	**5,00,000**
(%)	**(2.6)**	**(2.2)**	**(2.2)**	**(2.2)**
10. Fiscal Deficit	**6,00,000**	**6,25,000**	**6,50,000**	**7,00,000**
(%)	**(3.5)**	**(3.3)**	**(3.4)**	**(3.4)**

B. Proposals by the Finance Bill, 2019

True to the expectations of a populist Budget, and as indicated by the Finance Minister in his speech, the tax proposals have been introduced primarily to benefit the proletariat. While an attempt has been made at providing stimulus to the savings and investment behavior of these individuals and therefore, increasing consumption, an impetus to the affordable housing augurs well for the real estate industry.

Tax proposals

1. Tax rates

There has been no change in the tax rates for individuals as well as corporates. However, the benefit of lower tax rate of ~29% (inclusive of surcharge and cess) in FY 2018-19 continues to be available to domestic companies having turnover of INR 250 crores or less in FY 2016-17, and the said benefit of lower corporate tax rate has been extended to FY 2019-20 to domestic companies meeting the prescribed turnover criterion in FY 2017-18. There has been no reduction in the tax rates for LLPs/ firms from the current rate of ~35%.

2. Aids to the real estate sector – developers' standpoint

- For developers engaged in building affordable housing projects seeking to claim 100% deduction of profits[1], time limit for obtaining approvals from the prescribed authority has been extended to 31 March 2020 (from the existing limit of 31 March 2019).

- As a thrust to the real estate sector, [2]relief from tax on notional rent of properties held as stock-in-trade by the developers, but remaining vacant, is proposed to be extended to 2 years (instead of 1 year) from the end of the year in which construction completion certificate is obtained.

- The Finance Minister indicated that the GST Council is working towards a reduction in the GST burden relating to housing sector. While this will ultimately reduce the tax burden for home buyers, it will most certainly give a boost to the real estate sector.

Katalyst comment:
These proposals seem to provide impetus to the affordable housing sector and address the tepid demand in the real estate sector. Further, the increase in time limit for offering tax on notional rent on properties held as stock in trade should alleviate the notional tax as a result of supply glut in many regions.

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[1] Section 80-IBA of the Income-tax Act, 1961 (ITA)
[2] Section 23(5) of the ITA

3. Benefits to residential property owners/ buyers

- It is proposed that 2 residential houses will be eligible for classification as self-occupied property[3] (instead of one house, under the extant provisions). Therefore, where a person has 2 or more houses, the notional rent for any 2 houses will be considered as nil for tax purposes.

  Katalyst comment:
  It is a welcome move since it furthers the concept of "real" or "actual" income against notional income. However, the deduction towards interest on borrowings for acquiring both self-occupied properties remains capped at INR 2 lakhs.

- In case of long-term capital gains, not exceeding INR 2 crores, arising on transfer of residential property by resident individuals/ HUF, it is proposed[4] that an exemption from capital gains tax could be sought if such gains are invested in 2 residential houses in India (under existing provisions, said exemption could be availed towards reinvestment in 1 property only). The proposed exemption, however, can be availed by the taxpayer only once in his lifetime, at his option. This option is assessee-specific and not property-specific.

  Katalyst comment:
  The proposal to exempt capital gains, if such gains are invested in 2 residential house properties, is targeted to provide a relief to families seeking to separate into smaller houses. Also, owing to the self-occupied property related amendment, reinvestment in 2 residential properties saves the taxpayer from any disbenefit on the notional income front.

4. Other benefits to individuals

- Standard deduction from salary income has been increased to INR 50,000 (from INR 40,000).

- Rebate limit[5] increased to INR 5 lakhs (from INR 3.5 lakhs) for individuals i.e. individuals having taxable income of INR 5 lakhs or less will not be subject to tax. Comparison of tax liability before and after the proposed increase is tabulated below:

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[3] Section 23(4) and Section 24 of the ITA
[4] Section 54 of the ITA
[5] Section 87A of the ITA

Particulars	Scenario 1	Scenario 2	Scenario 3	
Gross Taxable Income	5,50,000	7,00,000	7,15,000	
Less: Deductions u/s 80C	1,50,000	1,50,000	1,50,000	
Less: Standard Deduction u/s 16	50,000	50,000	50,000	
Net Taxable Income	**3,50,000**	**5,00,000**	**5,15,000**	Incremental Income above rebate level= INR 15,000
Tax Payable	**5,000**	**12,500**	**15,500**	
Less: Rebate u/s 87A	5,000	12,500	-	
Net Tax Payable (After Amendment proposed in Finance Bill 2019)	-	-	**15,500**	Tax on incremental income = INR 15,500
Net Tax Payable (Before Amendment proposed in Finance Bill 2019)	***2,500***	***12,500***	***15,500***	

Above computation will be increased by Health and Education Cess @ 4%

Katalyst comment:

Since this benefit will be in the form of a rebate and not in the form of increase in base tax slab, small taxpayers (amounting to around 3 crores out of the total tax base of 6.85 crores taxpayers) will still be required to file the tax return.

Also, while the intent is to provide relief to small taxpayers, scenario 3 highlights a case where the income above the rebate level of INR 5 lakhs is lower than the tax payable. Where the objective is to cover small taxpayers, it would be ideal for such a disparity to be addressed.

5. **Increase in thresholds for withholding tax**

- In case of interest payments[6] (other than interest on securities) made to resident individuals by a bank, a co-operative society engaged in banking business or on notified deposit with post office, tax @10% will be required to be withheld if such amount exceeds INR 40,000 (instead of INR 10,000).

- In case of rental payments[7] made to residents, tax will be required to be withheld if such amount exceeds INR 240,000 (instead of INR 180,000).

Katalyst comment:

Increase in threshold for interest payments is expected reduce the compliance burden on senior citizen individuals for whom interest is the primary source of income.

Stamp duty proposals

The stamp duty provisions have been proposed to be amended with a view to rationalize the rates and streamline the collection mechanism.

[6] Section 194A of the ITA
[7] Section 194I of the ITA

Changes in the rates has been tabulated below:

Instrument	Existing rate	Proposed rate	Provisions
Shares - demat			
Transfer on stock exchange (delivery basis)	State-wise levy on Contract Notes (Maharashtra - 0.01%)	0.015%	Section 9A(1)(a) of Indian Stamp Act, 1899 (ISA) r.w. Article 56A
Transfer other than through stock exchange	Nil	0.015%	Section 9A(1)(b) r.w. Article 56A
Issue	State-wise levy (Maharashtra - 0.01%)	0.005%	Section 9A(1)(c) r.w. Article 56A
Shares – physical			
Transfer	0.25%	0.015%	Section 9B(b) r.w. Article 56A (Article 62(a) and (b) omitted)
Issue	State-wise levy (Maharashtra - 0.01%)	0.005%*	Section 9B(a) r.w. Article 56A
Debentures – demat			
Transfer of marketable debentures	0.05% per year of FV, subject to max of 0.25% or INR 25 lakhs, whichever is lower	0.0001%	Section 9A(1)(a) r.w. Article 27
Issue of marketable debentures		0.005%	Section 9A(1)(c) r.w. Article 27
Transfer of non-marketable debentures	Nil	0.0001%	Section 9A(1)(b) r.w. Article 27
Issue of non-marketable debentures	Nil	0.005%	Section 9A(1)(c) r.w. Article 27
Debentures – physical			
Transfer	Nil	0.0001%	Section 9B(b) r.w. Article 27
Issue	Nil	0.005%*	Section 9B(a) r.w. Article 27

* *Payable in the state where registered office is located*

- Further, the instrument on which stamp duty is payable under section 9A will be considered as the principal instrument and no stamp duty will be payable on any other instrument relating to the said transaction.

  Katalyst comment:
  The said amendments are likely to have the following impact:
  - *Streamlining state-wise levy of stamp duty on contract notes and therefore, addressing any "transaction-charge arbitrage" based on the domicile of the traders;*
  - *Additionally, seeking to levy stamp duty on transfer of shares held in demat form (which was earlier not within the purview of levy of stamp duty under the Indian*

Stamp Act, 1899). This amendment needs to be seen in the backdrop of compulsory dematerialization of securities of unlisted public company and therefore, would have a wider impact (in cases such as gift, inheritance, inter-se promoter transfers, etc.);

- *Reduction in stamp duty on transfer of shares held in physical format; and*
- *Levy of stamp duty on issue/ transfer of debentures notwithstanding the fact whether the same are listed or unlisted.*

C. What next?

While this was an Interim Budget and we expect a full-fledged Finance Bill during the Monsoon Session of the Parliament, it will be worthwhile to see how the collections will be matched with the expenditures proposed in the Budget. Not to forget, the New Tax Code is expected to be released for public comments by the end of February 2019, and its fate in light of the upcoming elections is currently uncertain.

Do feel free to reach out to us for a detailed discussion on ketan.dalal@katalystadvisors.in

Our Offices:

Mumbai
Forbes Building, 3rd Floor,
Charanjit Rai Marg, Fort,
Mumbai – 400001
Tel: +91 22 4917 1616

Pune
#402, Lunkad Sky Vista
New Airport Road,
Viman Nagar,
Pune- 411014
Tel: +91 20 6749 7700