Katalyst Kaleidoscope

February 2024: Interim Budget 2024-25

OUR ANALYSIS ON UNION BUDGET 2023 – 2024

TABLE OF CONTENTS

A. The Indian Economy: A Review and Key Budget Highlights

1. The Department of Economic Affairs, Government of India has released a document on January 29, 2024, which is in the nature of a diluted version of the Economic Survey, which is presented each year in the Parliament; the preface does state this is not an Economic survey, and that the Economic Survey will come before the full Budget after the general elections, but that this review takes stock of the state of the Indian economy and its journey during the last 10 years and offers a brief sketch of the outlook for the economy in the coming years.

   Some **key highlights from the preface** are as follows:

   - It now appears very likely that the Indian economy will achieve a growth rate at or above 7% for FY24, and some predict it will achieve another year of 7% real growth in FY25 as well. If the prognosis for FY25 turns out to be right, that will mark the fourth year post-pandemic that the Indian economy will have grown at or over 7 per cent.

   - The global economy is struggling to maintain its recovery post-Covid because successive shocks have buffeted it. Some of them, such as supply chain disruptions, have returned in 2024. If they persist, they will impact trade flows, transportation costs, economic output and inflation worldwide. India will not be exempt from it, but having faced and seen off COVID and the energy and commodity price shocks of 2022, India seems netter paced to deal with emerging challenges.

2. The survey also mentions of 3 relevant trends in the coming years.

   - The **era of hyper-globalisation in global manufacturing is over** and "governments seem to be pursuing onshoring and friend-shoring of production with a consequent impact on transportation, logistics costs, and, hence, the final prices of products".

   - **Advent of Artificial Intelligence will have profound and troubling questions** for growth in services trade and employment since technology might remove cost competitiveness advantages that countries exporting digital services currently enjoy.

   - **The energy transition challenge** and the single-minded focus on reducing carbon emissions and the complexity and trade-off between economic growth and energy transition.

3. The economic review also brings out **key challenges confronting the Indian economy**, primarily the following:

- In an integrated global economy, India's growth outlook does get impacted by spill over effect of global developments.

- Trade off between security and economic growth.

- The challenges of Artificial intelligence.

- Ensuring the availability of talented and skilled work force in a rapidly changing landscape.

4. The review also brings out the outlook in terms of statistics, including that the **GDP growth estimate for FY 2024 stands at 7.3%** and current account deficit as a result of resilient service exports and lower oil import cost have resulted in lowering India's current account deficit to 1% of GDP.

5. There are some interesting observations regarding **"enabling investment led economic growth"** including the following:

   - The Government has helped banks strengthen their balance sheets by recapitalizing them.

   - With stronger balance sheets in the non financial corporate and banking sectors, growth in investment and credit are poised to increase in this decade (the investment rate has gone up from 27.3% of nominal GDP to 29.8% of nominal GDP).

   - The capital expenditure by the public sector has gone up from 5.6 lac cr in FY 2015 to approximately 18.6 lac cr in FY 2024 (estimated) which is a combination of capex, grants for capital asset creation and resources of public sector enterprises.

   - Bank credit for housing has gone up from 5% of GDP to 8.7% of GDP.

6. **Logistics** is a significant issue and in this context, the **review deals in reasonable detail with this sector** and some key aspects mentioned therein are as follows:

   - The Unified Logistics Interface Platform under the National Logistics Policy, is integrated with 35 systems of 8 different Ministries and intends to simplify and improve the ability of logistics processes for registered users. GST data is also being integrated therewith.

   - The average turnaround time (per day) at major ports has gone down from 4.2 days during FY 2004 – FY 2014 to 2.9 days thereafter.

- Logistics Cost for Trucks after implementation of GST has gone down roughly from 14% to slightly over 10% (as a % of total value).

7. Some **key ratios of public sector banks** have improved as shown by the table below:

Particulars	**2013-14**	**2022-23**
Net Interest Margin (NIM)	2.45	2.72
Return on Assets (RoA)	0.50	0.79
Return on Equity (RoE)	8.48	12.35

Source: RBI

8. In relation to **FDI**, subdued global trends have been dictating the course of FDI flows to India lately. Despite this, India continues to chart its way forward and remain a preferred destination among investors. In the ten years between FY05 and FY14, India's cumulative FDI inflows were USD 305.3 billion. The cumulative nominal GDP in that period was USD 13.55 trillion. The FDI inflows were thus 2.2 per cent of GDP in that period.

   In the nine years between FY15 and FY23, India received a cumulative FDI of USD 596.5 billion and the cumulative dollar GDP in that period was USD 23.8 trillion.

9. The **concluding paras deal with the outlook in the next few years** and some **key extracts** are as follows:

- Ten years ago, India was the 10th largest economy in the world, with a GDP of USD 1.9 trillion at current market prices. Today, it is the 5th largest with a GDP of USD 3.7 trillion (est. FY24), despite the pandemic and despite inheriting an economy with macro imbalances and a broken financial sector.

- There is, however, considerable scope for the growth rate to rise well above 7 per cent by 2030. The speed with which physical infrastructure is being built will allow the ICOR to decline, translating private investments into output quickly. The IBC has strengthened balance sheets and, in the process, has freed up economic capital that was otherwise rendered unproductive. The rapidly expanding digital infrastructure is continuously improving institutional efficiency.

- Furthermore, under a reasonable set of assumptions with respect to the inflation differentials and the exchange rate, India can aspire to become a USD 7 trillion economy in the next six to seven years (by 2030). This will be a significant milestone in the journey to delivering a quality of life and standard of living that match and exceed the aspirations of the Indian people.

10. Key highlights from the interim budget for 2024-25 are summarized as follows:

a. Fiscal deficit estimate for FY 24-25 has been revised downward to 5.1% of the total GDP, against 5.8% in FY 23-24, with tax revenues estimated to be INR 11.7 Crore for FY 24-25 (as opposed to INR 11.6 Cr in FY 23-24).
b. People centric Inclusive development with focus on infrastructure with an capital outlay of INR 11.11 Lakh Crore, and building digital public infrastructure, financial inclusion, health, and housing for all;
c. Strengthened financial sector, with key focus on development of GIFT IFSC, and proactive inflation management;
d. Financial support to the weaker sections of the society, farmers, women, and empowering youth through skill development, and loans;
e. Vision for structural initiatives:
    i. **Sustainable Development:** Commitment to Net Zero by 2070 by focusing on alternative/ renewable sources of energy, Rooftop solarization, E-busses and e-public transport, and Biomanufacturing initiatives;
    ii. Focus on infrastructure and investment: Focus on promotion of foreign investment through bilateral investment, development of rail corridors, airports, urban transformation through metro rail, etc.
    iii. Other Areas: Focus on tourism, agriculture and food processing, etc.

B. Key Direct Tax Changes

In line with the expected outcome, certain limited amendments to direct taxes have been proposed in the Finance Bill, 2024, given that the same was a vote on account budget. These amendments mainly pertain to extension of sunset dates, and partial rationalisation of TCS provisions on Liberalised Remittance Scheme. Key highlights vis-à-vis direct taxes are captured hereunder:

1. There has been no change in tax slabs for individuals, and tax rates for individuals, corporates, partnership firm, and other entities; one hopes that there is some downward rationalization later this year.

2. Extension of sunset dates:

    a. **Investments by Sovereign Wealth Funds and pension funds:** Presently, any income (capital gains, dividend, and interest) on investment made by certain specified persons including Abu Dhabi Investment Authority, notified sovereign wealth funds, and pension funds are exempt from tax under section 10(23FE) of the Income-tax Act, 1961 ("IT Act"). This exemption was available if such investments were made prior to 31 March 2024; this sunset date has been extended to 31 March 2025.

    b. Profits of Eligible Startups: Presently, profits of eligible startups are not subject to tax for a period of 3 consecutive years under section 80-IAC of the IT Act, if such startup is incorporated before 1 April 2024; this sunset date has been extended to 1 April 2025.

    c. IFSC Related Sunset Clauses:

        i. **Income of Offshore Banking Unit:** Presently, any income earned by the investment division of offshore banking unit (or through its registered Category I FPI) is exempt from tax under section 10(4D) of the IT Act. This exemption was available if the operations of such offshore banking unit had commenced prior to 31 March 2024; this sunset date has been extended to 31 March 2025.

        ii. **Royalty or interest on lease of aircraft or ship:** Presently, any royalty or income paid by a unit in IFSC to a non-resident by way of royalty or interest is exempt from tax under section 10(4F) of the IT Act. This exemption was available if the operations of such unit in IFSC had commenced prior to 31 March 2024; this sunset date has been extended to 31 March 2025.

iii. **Income on transfer of aircraft or ship:** Presently, any income arising from transfer of aircraft or ship, which was leased by a unit in IFSC, is exempt from tax under section 80LA of the IT Act, subject to a certain number of years. This exemption was available if the operations of such unit in IFSC had commenced prior to 31 March 2024; this sunset date has been extended to 31 March 2025.

Note - No extension for new manufacturing units: Presently, section 115BAB of the IT Act provides that any income from a new manufacturing unit shall be subject to a lower corporate tax rate of 15% (as against 22%), excluding surcharge and cess, subject to certain conditions, provided if such manufacturing unit is set up and has commenced operations prior to 31 March 2024. However, this sunset date has not been extended, which would mean that any corporate entity setting up a new manufacturing unit would be subject to the normal corporate tax rate at 22%, excluding surcharge and cess.

d. **Partial rationalization of Tax Collection at Source ("TCS") under Liberalised Remittance Scheme ("LRS"):** Presently, TCS on remittances made under LRS is subject to upfront TCS (which is available as credit while computing taxable income, but resulting in an upfront cash outflow), generally at the rate of 20%, resulting in a substantial upfront cash outflow. The said provisions have been partially rationalised as under:

i. Rate of TCS has been reduced from 20% to 5% with retrospective effect from 1 July 2023;

ii. No TCS is applicable on remittances which are below INR 7 Lakhs, with retrospective effect from 1 July 2023 – earlier, the limit was only applicable in case remittances are made for the purposes of education or medical treatment;

iii. However, any remittances, other than remittances made for the purposes of education or medical treatment, made in excess of INR 7 Lakhs, post 1 October 2023, shall be subject to TCS at 20%;

iv. Remittances for the purposes of education or medical treatment shall be subject to 5% without any upper cap;

v. With retrospective effect from 1 October 2023, TCS shall be collected at 20% by the seller of an overseas tour package, if amount is in excess of INR 7 Lakhs.

e. It has been proposed that any outstanding direct tax demands upto INR 25000 upto FY 10 and upto INR 10000 from FY11 to FY15 shall be withdrawn, and is likely to benefit approximately INR 1 Cr taxpayers and reducing tax litigation.

C. <u>Key Indirect Tax Proposals</u>

1. Amendment in definition of Input service distributor ('ISD') and manner of distribution of ITC by the ISD

Earlier, the definition of ISD mainly allowed the ISD to receive the invoices of input services only in its name and was not allowed to pay GST. It is now proposed that, ISD would be allowed to receive the invoices on which GST is payable under RCM by ISD on behalf of the distinct persons. Thus, ISD has been given an option to pay GST on behalf of distinct persons and allowed to distribute such credit on which GST is paid under RCM by ISD to the respective distinct persons. Also, ISD making payment of GST under RCM on behalf of the distinct person is compulsorily required to register under GST Law.

2. **Penalty for failure to register certain machines used in manufacture of goods**

Penalty is proposed to be levied at INR 1 Lakh per machinery, in addition to the existing penalties under Chapter XV. Further, non-registration of machinery is also subject to seizure and confiscation subject to non-fulfilment of certain conditions.

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