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Union Budget 2004 : An Analysis

The Union Budget was presented to the Lok Sabha by the Finance Minister P Chidambaram on July 8th, 2004. The annual budget is a statement of intent on the priorities of the Government of India, especially in the context of a landmark election held earlier in the year. The United Progressive Alliance's (UPA) National Common Minimum Programme (NCMP) prioritised human development, agriculture and employment. While the budget did take a step forward in delivering a boost to agriculture and the rural economy, it has fallen short of expectations in many other areas including human development. Besides across the board increases in all these sectors, it does little to address the real concern that the delivery systems are often what fail the allocations.However, while it is easy to be critical of the Finance Minister's effort, any analysis of the budget has to be viewed in the context of the skillful jugglery to balance the demands of the various allies of the government, delivering on the promises of the national common minimum programme and managing the expectations of the stock market. When seen in this light, the budget is one, which if implemented properly, will help to create a favourable economic environment for development and employment.

By the time of finalising this article, the Finance Minister had already begun the post-budget ritual of rollbacks. The first casualty was the transaction tax on all transactions in the stock market, which has now been watered down considerably. Other expected rollbacks are the postponement of the divestment in the National Thermal Power Corporation (NTPC) and delays in increases Foreign Direct Investment (FDI) in aviation, telecom and insurance. Changes like the roll back of the transaction tax have revenue implications (usually reductions), which have a domino effect on the rest of the budget where allocations are reduced often in an ad-hoc manner. Therefore, though the budget has made increased allocations for rural development and agriculture as per the intent of the NCMP, the real test comes six months later when revenue shortfalls (through roll backs or inaccurate projections) will necessitate reductions in allocations across all sectors.

For the purposes of clarity, this analysis is split into the two broad categories of Revenue and Expenditure. The analysis of expenditure is then done with a focus on the development sector, split into various heads as per allocations to each ministry in the government.

Revenue

The budget has managed to maintain good balance in revenue with control over the fiscal deficit without unexpected increases in taxes. The good news on exemption of tax liability(100%) for those with income upto Rs.1,00,000 and reduction of income tax for those with incomes between Rs.1,00,000 and Rs.1,11,240 is tempered by the realisation that there are no tax cuts for any other income category. At the same time, the hope raised by the imposition of a 2% cess on all taxes to fund primary education is somewhat dampened by the fact that the benefits of this scheme will kick in only next year when the cess is collected and distributed to local governments through the states.Healthy scepticism on the fiscal deficit is also necessary when income and corporate tax revenues are projected to go up by 26% and 40% respectively.

While the turnover tax of 0.15% might have helped reduce the volatility in the market, it has already been watered down with revenue from that source expected to reduce by over Rs. 60 billion (6,000 crores). The first statement of intent towards bringing in a Value Added Tax (VAT) regime was made through the budget. The experience of the state of Haryana suggests that the introduction of VAT can be revenue positive which can act as an incentive for other states to stick to deadline of March, 2005. As it is a proportional tax, it hurts the poor disproportionately more. This being the case, it is important to ensure that food, clothing, medicine and other items that form a large part of the basket of goods bought by the poor are excluded from VAT.

Expenditure

Agriculture

The budget has been faithful to the NCMP and it has as promised, delivered the much needed boost to agriculture, which has been overdue since successive failures of monsoon rains across the country. Overall, the grant to the Ministry of Agriculture has increased by over 21% when compared to the previous year.

The budget makes an express promise to support horticulture but the total allocation to it is still just Rs. 3.8 billion (380 crores) though it is double the total allocation of the previous year. While allocations seem to be in the right direction, the desire of the Minister to replicate the ‘Anand’ model of cooperatives needs to be supported by institutional changes that can facilitate their smooth functioning. The ‘Anand’ model backed by sustained government assistance is responsible for the India’s self-sufficiency in milk through the‘ Operation Flood’ programme. A similar programme in oilseeds (Operation Golden Flow) without good institutional support has been notably less successful. The support to oilseeds in the current budget is to the extent of Rs. 1.5 billion (150 crores).

Though the budget does state an intention to double agricultural credit along with a move to make a sponsor bank accountable for disbursal of credit through rural co-operative banks, clarity on implementation is still awaited. Other issues that need to be monitored include the implementation of the new Agriculture Produce Market Committee (APMC) Act across the country and steps to increase the Small Farmers Agri-Business consortium as also the Agricultural Insurance scheme.

Education

An economic objective of the NCMP was to provide universal access to quality basic education for which a 2% surcharge on taxes was levied. The expectation of such a levy was that it would help to increase funds and promote access to primary education with a special emphasis on provision of mid-day meals at all schools. However, the collection of the cess will bring in rewards only by the next financial year. Keeping that amount apart, the increase in education spend is around 8% with the big gainers being the Nutrition Support to Primary

Education (NSPE) and the Sarva Shiksha Abhiyan (SSA) where expenditure increased by 22% and 12% respectively. However there was a 25% reduction to Rs. 6 billion (600 crores) on the District Primary Education programme (DPEP).

In Secondary and Higher education, both the Kendriya Vidyalaya Sangathan and the Navodaya Vidyalaya Samiti witness a decrease in funds with Information Communication Technologies in Secondary Education being the major gainer by over Rs. 720million (72 crores). Spending on higher education has increased on average by just 5% but it still remains disproportionately high (per capita) compared to primary and secondary education. Some correction of the small amounts spent on the Industrial Training Institutes (ITI's) seem to have taken place with a small increase in funding for these institutes. Though the education loan scheme has been extended for amounts upto Rs. 750,000 (7.5 lakhs) for those in higher education, it is no guarantee for ensuring access for all in higher education. Access for all will require that fees be based on the outcomes of education and not on inputs, when students repay their fees based on their salary after their education.

Defence

A worrying trend in India today is the steep increase in defence allocation over the last five years. Expenditure has almost doubled with this budget taking allocations to Rs. 780 billion (78,000 crores)(up 25%). Whether this is a grant to clear the large backlog of orders for the upgradation of machinery (capital expenditure accounts for most of this increase at Rs. 330 billion (33,000 crores)) or a permanent increase in expenditure remains to be seen. Research and Development allocations also increased with a similar magnitude to Rs. 17 billion (1,700 crores). However, while India continues to talk peace with its neighbours, the continually higher expenditure on defence can scarcely be justified.

Health

The Universal Health Insurance scheme needs to be commended especially with the plan to increase coverage to about one million households in the next year. The total allocation to health goes up by just 5%, which in real terms is a stagnation in spending. Considering the highly privatised healthcare market in the country and the lack of coverage of healthcare across the country, innovations and new ideas are necessary for the programme to succeed. A successful innovation like the 'Yeshaswini' model in Karnataka where delivery of limited health insurance through rural co-operatives with the incorporation of private health providers could facilitate the provision of healthcare for all.

Medical education continues to have a large percentage of the health budget and other gainers in the health budget include the National AIDS control programmes (allocation up 13% to Rs. 2 billion (200 crores)). The National Anti-Malaria Programme and the TB Control Programme are other gainers. While the move to provide 100% deduction of profits for beds set up in rural areas is a welcome one, it remains to be seen if it simply helps to set up expensive hospitals (inaccessible to the poor) on the periphery of major urban centres, which then defeat the purpose of this incentive.

Rural Development

As stated in the NCMP, the emphasis on agriculture, employment and growth was highlighted in the rural development budget, which has seen an increase of around 26%. The allocation to the Swarna Jayanti Gram Swarozgar Yojna (SGSY) has increased 25% to Rs. 9 billion (900 crores). On the other hand, the Sampoorna Gramin Rozgar Yojna (SGRY) allocation is down by 9% with both the food and special components of the programme going down by 75% each. This amount has been re-allocated to the food for work programme of the SGRY, which seems to be in line with the plan to provide 100 days of assured employment at minimum wage to one the breadwinner in a household. Programmes like the Indira Awas Yojna and the Rajiv Gandhi Drinking Water Supply mission also receive higher spends with an idea of promoting universal access to both housing and drinking water. The big question mark that remains is on the delivery of these programmes and how governance and policy structures will be created to ensure that money is well spent and people benefit from the programmes.

The newest programme of the current government: the Pradhan Mantri Grameen Jal Samvardhan Yojana is allocated Rs. 2 billion (200 crores) for a pilot project in five districts to revive all the lakes and water bodies. The stated intention of the Finance Minister is to undertake this project on a nationwide scale. If this is to happen, the support of the Prime Minister's office itself is necessary much like that given to the National Highways Authority of India.

Urban Issues

Most of the expenditure in the Urban Development Ministry has been for the construction and maintenance of central government establishments with some increases for urban water supply. The total allocation to the Ministry was down 60% with the Delhi Metro Railway Corporation (DMRC) witnessing a 70% fall in allocation. The ministry of Urban Employment and Poverty Alleviation has seen an increase in allocation from Rs. 6.7 billion (670 crores) to Rs. 8.4 billion (840 crores). The major gainers are water supply and sanitation projects as also the Valmiki Ambedhkar Awas Yojna (VAMBAY). All other programmes including the Swarna Jayanthi Shahari Rozgar Yojna (SJSRY) go on as usual.

Water Resources

Though the management of water resources has been given priority, the total allocation to this Ministry is still small. Most items of expenditure remain the same with items that have gained being for flood control (at Rs. 2.2 billion (220 crores)) and command area development (at Rs. 1.8 billion (180 crores)). The announcement that the Accelerated Irrigation Benefit Programme will be now implemented on a 'fast track' basis needs to be applauded. Though Rs. 28 billion (2800 crores) has been allocated to the programme as per the budget speech, it is not clear which ministry it is being routed through as the total allocation to the Union Water Ministry is just Rs. 8.3 billion (830 crores).

Others

For all the claims that that the current government makes on promotion of equality and the development of socially and economically weaker sections of people, it has not been backed by greater allocations for the same. While the FM has acknowledged the role of self help groups (SHG's) to provide banking services to the poor, the target of just half a million SHG's over the next three years can at best be described as modest from any perspective. Greater budget support and zeal in promoting this concept is necessary to provide banking services for the poor. Similarly, the total allocation to the Ministry of Social Justice is in the range of the allocation in the previous year at Rs. 15 billion (1500 crores). The Minister announced that the National Institute of Public Finance and Policy has been asked to prepare a blue print to 'target' subsidies at the poorest and most needy candidates. This is a consultative process that all civil society groups need to be engaged in to support better targeting but at the same time not support reductions that will adversely affect food security and other basic rights of the poorest.

Handloom industries should welcome the exemption provided to tax through the new tax proposals of the budget. The identification of small-scale industry (SSI) as an engine for growth is a welcome albeit late step. The allocation of monies under the Capital Subsidy Scheme as also the Promotion of SSI's Scheme is a necessary step to promote small industry that can help to address the needs of that sector. The promise to open a fund for regeneration of traditional industries with an initial allocation of Rs. 1 billion (100 crores) is a small but welcome step.

Summary and Conclusions

While it will be blatantly unfair to condemn the budget as being short on ideas with large question marks on implementation, it certainly is a step forward in democratising development through the length and breadth of the country. If the difficult issues of governance and implementability of the budget proposals are handled well, the union budget together with the NCMP of the United Progressive Alliance represents a serious attempt at providing growth with equity.

Many proposals of the government like higher expenditure in education and marginally higher spend in healthcare are welcome. So too is the focus on rural India through agriculture and traditional small-scale industry. These industries have received a vital boost, which is necessary in order to ensure that India can attain and maintain a growth rate of 8% (necessary for meeting the Millennium Development Goals) in the foreseeable future. In both Agriculture and small-scale industry, the policy prescriptions seem to be to increase the diversification in order to ensure that individual income is not lost or significantly reduced through seasonal factors. This is highlighted in the emphasis on horticulture, the move towards insurance of farm income rather than crop insurance and the promotion of rural industry as suggested by the Prime Minister himself. However, this needs to be complimented with an extensive and aggressive education and training component across the country for it to provide a basic standard of living to people.

There remain concerns on India's rising defence budget, the continued policy to roll back taxes after their announcement, which in turn affects every single item on the budget adversely. Some objectives of the National Common Minimum

Programme are still left unclear with efficient utilisation of funds still a concern among all stakeholders. While the public pronouncements of the mandate of 2004 has been for the emphasis on rural India, it is the role of civil society groups, citizens and pressure groups to be constantly reminded of the message of the elections where development itself becomes freedom. And where economic growth is necessary but with equity. The creation of a new development paradigm as outlined by the Prime Minister is a crucial part of the exercise to ensure growth with equity to create an India that is modern, developed and inclusive.

Jacob John
Research Associate, FMSF

Salient Features of the Finance (No.2) Act, 2004 : Relevant for Non-Profit Organisations and Individuals

Budget is an annual exercise undertaken by the Finance Minister to present the estimates of receipts and expenditure for the next financial year. The new Finance Minister, Mr. P. Chidambaram also presented the first Budget of the new Central Government on 8th July, 2004. The Budget addresses the issues of agriculture, rural economy, education, unemployment, drinking water etc. There are also proposals to ensure the growth of industry, servicesector and business besides giving impetus to agriculture, rural infrastructure, education and health.

Linked with the exercise of presenting the budget is the exercise of carrying out amendments to the various central tax laws. Keeping with the tradition of previous years, this year also our new Finance Minister has proposed various amendments for the sake of simplification and rationalisation. The Finance (No.2) Bill, 2004 has been passed by the Lok Sabha with a total of 55 amendments. With the President giving his assent to the Act on September 10, 2004, the Finance Act has been enacted into a law i.e.The Finance(No.2)Act, 2004. The amendments affecting the individuals and Non-Profit Organisations are provided in the following sections:

Section I: Amendments relevant for Non-Profit Organisations.

Section II: Amendments in provisions of Tax deducted at Source.

Section III: Amendments affecting Individuals

Section IV: Amendments in Service Tax and Value Added Tax

SECTION I :

AMENDMENTS RELEVANT FOR NON - PROFIT ORGANISATIONS

1. Cancellation of registration of trust registered under section 12AA and withdrawal of approval

As per the existing provisions of the Income Tax Act, the registration given to trusts or institutions under section 12AA for claiming exemption from payment of income tax can’t be revoked by Income Tax Department once it is given. The Finance Act 2004 has amended Section 12AA. Now, it gives power to the Commissioner of Income Tax (CIT) under sub section (3) of section 12AA to cancel the registration granted under subsection (1) of Section 12AA if the CIT is satisfied that the activities of any trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution after giving a reasonable opportunity of being heard.

Appeal to the above order

As per the existing provisions of Section 253(1)(c), the order passed by the Commissioner under Section 12AA is an appealable order. Therefore, the above order passed by the CIT cancelling the registration shall be appealable to the Income Tax Appellate Tribunal.

2. Withdrawal of approval given under section 35 AC to certain associations and institutions.

Similar to the above provisions, the National Committee which grants approval under Section 35AC for carrying out eligible project or scheme is also empowered to withdraw the approval where the association or institution fails to furnish to the National Committee a report in the prescribed form and time, after the end of each financial year. However, the National Committee has to give a reasonable opportunity of being heard to the organisation.

Appeal to the above order

This order of the withdrawal of the approval by the National Committee is not an appealable order.

Both the amendments shall be effective from 1st October, 2004.

SECTION II

AMENDMENTS IN PROVISIONS OF TAX DEDUCTED AT SOURCE (TDS)

1. Scope of tax deduction on payment to contractor widened

Deduction of tax at source from payments to contractor and subcontractor is governed by section 194C of the Income Tax Act. As per the existing provisions no tax is required to be deducted at source from any sum credited or paid in pursuance of any contract, the consideration for which does not exceed Rs.20,000/-. That is, if the consideration for an individual contract does not exceeds Rs.20,000, no tax is required to be deducted.

To prevent the practice of splitting the contract to less than Rs.20,000, the Finance(No.2)Act 2004 has amended Section 194C(3) to provide that tax shall also be required to be deducted in respect of a contract where the amount credited or paid to a contractor or subcontractor exceeds Rs.50,000 in the aggregate during a Financial Year. This amendment shall be effective from 1st October, 2004.

Some Highlights……….

- ¥ No change in the existing tax rate. 2 per cent additional surcharge on account of education cess.
- ¥ Rebate of tax under Sec.88D in case of individuals having income upto Rs.1,11,240.
- ¥ Commissioner of Income Tax can cancel the registration granted under Section 12AA (1) to charitable trusts and societies.
- ¥ New provisions for issue of TDS Certificates.

So, w.e.f 1st October 2004, tax would be required to be deducted from the amount credited or paid to a contractor or sub-contractor in the following cases:

¥ The amount of an individual contract exceeds Rs.20,000 OR

¥ In case of more than one contract with the same contractor or sub-contractor, the aggregate amount of payment during the financial year exceeds Rs.50,000.

2. TDS returns in hard format (in papers) can now be filed with any authority or any agency

The Finance Act has provided that the paper TDS return required to be filed under Section 206(1) can now be filed with any authority or agency specified by the Central Board of Direct Taxes. This amendment has been made to implement the scheme of filing TDS return with National Securities Depository Limited (NSDL) or Unit Trust of India (UTI) instead of with the Assessing Officer so that the data of the paper return can be digitalised. This amendment shall be effective from 1st October, 2004.

3. No requirement to issue TDS certificates.

The Finance Act has changed the procedure for the issue of TDS certificates. Provisions of Section 200 and 203 are amended to provide the following:

1. There shall be no requirement for the issue of TDS certificate in Form no 16 or 16A by the deductor on or after 1st April 2005.

4. Prescribed authority to issue annual statement to deductee

Instead, the prescribed Income Tax Authority such as NSDL or UTI shall issue a yearly statement to the person from whose income the tax has been deducted specifying the amount of tax deducted or paid or such other particulars as may be prescribed as per the above scheme.This will be intimation to the deductee of the amount deducted and paid by various deductors on his behalf.

5. Deductor to submit quarterly statement

However, an additional obligation is being put on the deductor to prepare and submit quarterly statement for the period ending on 30th June, 30th September, 31st December and 31st March in each financial year in the prescribed form, in respect of the tax deducted and paid, to the prescribed income tax authority. Failure to file such statement within the time shall be liable to penalty under Section 272A(2) at the rate of Rs.100 for every day during which the default continues.

So, the deductor shall now be required to file one annual return and four quarterly statements, but will not be required to issue TDS certificate. Instead, on the basis of the quarterly statement, annual statement shall be issued to the deductee by the tax authority on the basis of which the credit shall be allowed to the deductee without enclosing any TDS certificate with the return of income.

Consequently the provisions of Section 139(9) have been amended to provide that the return shall not be treated as defective where TDS certificates are not enclosed. To implement the above scheme, all assesses including nonresidents shall now be required to intimate the Permanent Account Number to the person deducting or collecting tax so that the credit for the TDS can be given. The above amendment shall be applicable from 1st April, 2005.

SECTION III:

AMENDMENTS AFFECTING INDIVIDUALS

TAX RATES

1. No change in the existing tax rates. 2 per cent additional surcharge on account of education cess

There is no change in the rates of tax applicable to individuals, Hindu Undivided Family (HUF), firms, companies etc. However, taxpayers have to pay an additional surcharge at the rate of 2 per cent on the amount of tax payable. Accordingly one has to compute the tax liability on the basis of existing tax rates, add existing surcharge of 10%, if the total income exceeds Rs.8,50,000 and on that amount, a further 2 % has to be added. This 2 % additional surcharge on account of education cess is also to be added while computing tax deductible at source by the deductor.

2. Rebate of tax in case of resident individuals having income upto Rs.1,11,240

The Finance (No.2) Act, 2004 has inserted a new section 88D. Under the above section, the resident individuals having taxable income up to Rs.1,00,000 shall not be required to pay any tax by availing the rebate under section 88D.

Further, those having taxable income more than Rs.1,00,000 but less than Rs.1,11,240 shall also be allowed a marginal relief by way of rebate under section 88D. The amount of rebate according to the amount of taxable income is given in the table below:

S.No.	Amount of Taxable Income	Amount of Rebate
i)	When taxable income is upto Rs.1,00,000	100% of Income tax payable
ii)	If total taxable income exceeds Rs.1,00,000 but does not exceed Rs.1,11,240	Total Tax payable Less (Total income – Rs. 1,00,000)

Examples on the calculation of the rebate amount in different cases are given below:

a) If taxable income of a resident individual is Rs. 1,00,000.00. Tax liability is zero after rebate under Section 88D.

b) If taxable income of a resident individual is Rs.1,11,000.00. Tax liability will be Rs.11, 000 as computed below in the box:

Step1:			
	Total taxable income	=	Rs. 1, 11,000
Step 2:			
	Tax payable on Rs. 1,11,000.00	=	Rs. 11, 200
Step 3:			
	Rebate u/s 88D	=	Tax payable– (Total income – Rs. 1,00,000)
		=	Rs. 11,200.00– (Rs.1,11,000 – Rs. 1,00,000.00)
		=	Rs. 200
Total tax			Rs. 11,200.00
Less : Rebate u/s 88D			Rs. 200.00
Net tax payable			Rs. 11,000.00
Add: Education Cess @ 2%			Rs. 220.00
Total Tax liability			Rs. 11,220.00

This exemption is available for resident individuals only and as such the benefit will not be available to non-resident and other entities such as HUF, association of persons or body of individuals. However, the persons who get covered by this exemption shall be required to file the return.

c) But if the taxable income is more than Rs. 1,11,240.00 say Rs. 1,12,000.00, then rebate u/s 88D is not available and the total tax liability in this case will be Rs. 11,400.00.

In other words, the provision is aimed at providing a marginal relief to the individuals having income between Rs. 1,00,000 and Rs.1,11,240 so that his income after tax is not lower than Rs.1,00,000 (if education cess is ignored)

3. Long-term Capital Gain from transfer of equity shares of a company or units of equity oriented funds on or after the notified date and covered by Securities transaction tax will be exempt.

The Finance Act has introduced a new subsection 38 to section 10 exempting Long-term Capital Gain on the transfer of securities. This exemption shall be available to all assesses, both residents and non-residents. It is, however, subject to following conditions:

The transaction on the sale of such securities is entered into in a recognized stock exchange in India. Accordingly those securities which are not listed shall not be eligible. The income should arise as an investor, not as a trader.

The asset which is transferred is long-term capital asset.

The transaction is chargeable to securities transaction tax.

The transaction takes place after the date as will be notified later by Ministry of Finance.

Therefore, now the long-term capital gain is not chargeable to tax. Conversely, if the above conditions are satisfied and assets are transferred at a loss, such long-term capital loss cannot be set off against any income in the year in which the loss is incurred or in a subsequent year.

4. Short-term Capital Gain on listed securities to be taxed at the rate of 10 per cent

The Finance Act has introduced a new Section 111A which is similar to the above discussed section. According to it, 10 percent tax (plus surcharge plus education cess)is to be paid on income from transfer of short term securities entered through a recognised stock exchange in India. The other terms and conditions under this section is similar to section 10 (38) discussed above i.e.

The transaction on the sale of such securities is entered into in a recognised stock exchange in India on or after the date as will be notified later by Ministry of Finance.

The income should arise as an investor, not as a trader.

Such transaction is chargeable to securities transaction tax.

5. Securities Transaction Tax (STT)

A new Securities Transaction Tax (STT) has been levied on the value of taxable securities transactions. In case the transaction of equity shares in a company is entered into in a recognised stock exchange in India, the contract for the purchase or sale of equity shares in a company can be settled in either of the following two ways. The taxability will be different in two cases as follows:

i) By actual delivery or transfer of such shares: The STT at the rate of 0.075% will be levied on the buyer as well as seller.

ii) Without actual delivery or transfer of such shares: The STT at the rate of 0.015% will be levied only on the seller and not the buyer.

The tax will be levied on the transactions that takes place after the date as will be notified later by Ministry of Finance. However, no STT is payable on the sale or purchase of Government securities, bonds, debentures, units of mutual fund other than equity oriented mutual funds.

Further, this tax needs to be paid irrespective of whether there is a income or loss. The securities transaction tax should be collected by the stock exchange itself.

4. Rebate in respect of Securities Transaction Tax (Sec.88E)

The individual assesses will also get the rebate under section 88E equivalent to the quantum of STT paid if the following conditions are satisfied:

Income of the individual includes any income chargeable under the head“ Profit and gains of business or profession” arising from taxable securities transaction and,

Such individual furnishes along with the return of income evidence of payment of securities transaction tax in the prescribed form.

SECTION IV:

AMENDMENTS IN SERVICE TAX AND VALUE ADDED TAX ACT

SERVICE TAX

1. Increase in Rate of Service Tax

The present rate of service tax has been increased from 8% to 10%.

2. Some more services brought under the net of Service Tax Act:

The following services have been brought under the net of Service tax.

Business exhibition services;

Airport services;

Services provided by transport booking agents;

Transport of goods by air;

Survey and exploration services;

Opinion poll services;

Intellectual property services other than copy right;

Brokers of forward contracts;

Pandal and shamiana contractors; outdoor caterers;

Independent TV/radio programme producers;

Construction services in respect of commercial or industrial constructions; and

Life insurance services to the extent of the risk premium

Travel agents (other than Air/Rail travel agents).

3. 2% additional Education Cess on Service Tax

An additional cess of 2% on the service tax payable has been levied.

VALUE ADDED TAX

1. Introduction of Value Added Tax from April 1st, 2005

The Value Added Tax will be introduced from April 1st, 2005.

Purnima Jolly / Rahul Khanna
Project Monitoring Officer,
FMSF

Cash Flow Statements :
Some Commonly Asked Questions

What is a Cash Flow Statement?

From a lay person's understanding, cash flow statement means the summary of cash inflows and outflows from various activities over a period of time.

Why should an organisation prepare a Cash Flow Statement?

Many times, it is seen that an organisation may have a financial viability over a longer period of time. However, in order to undertake the activities of the organisation at all times in a smooth manner, it is important to ensure that the liquidity of the organisation is maintained. An example will make things more clear. If monthly salary bills of your organisation comes to Rs.10,000/- (Rs.1,20,000/- per annum), then you will need Rs.1,20,000/- per year of cash inflows to take care of the salary bills. But that is not enough. Unless, you receive the amount in monthly installments of Rs.10,000/- at least, you will not be in a position to pay the salaries on time. Therefore, while on one hand the budget is important to prepare, unless we have the cash flow along with it, the organisation may face difficulty in carrying out its operations.

Benefits of preparing Cash Flow Statement

A Cash Flow Statement prepared along with other Financial Statements provides information about the liquidity position of the organisation. Cash Flow information is also useful in assessing the ability of an organisation to generate cash which would help in undertaking activities and programmes. Further, it also gives an idea whether short term receipts have been used for long term investments.

What do we understand by cash?

Generally, cash includes cash in hand, cash at bank as well as short term highly liquid investments that are readily convertible into cash.

What are the areas a Cash Flow Statement should include?

The Cash Flow Statement should include three areas:

(a) The cash inflow/outflow of the normal activities/programmes of an organisation.

(b) The cash flow from acquisition of long term assets for an organisation.

(c) The cash flow from taking long term/short term loans or repayments thereof.

Frequency of preparing a Cash Flow Statement

Generally, an annual Cash Flow Statement is prepared which is actually a sum total of various monthly cash flow plans.

Should non-cash transactions be included?

By its very name, non-cash transactions are excluded from Cash Flow Statement.

Treatment of foreign currency cash flows

Foreign currency cash flows should be recorded in the local currency at the value on the date it was converted to local currency. If there was any effect of changes in exchange rates (exchange rate gains/ losses) held in foreign currency, it should be separately shown in the Cash Flow Statement.

Treatment of interest

Any interest received should be treated as cash inflow. However, if the interest is accrued and due but not received yet, it should be kept out of Cash Flow Statement.

Conclusion

Preparation of Cash Flow Statement is a very useful tool for internal monitoring and efficient cash flow management. Cash Flow Statement can help us in taking a holistic view of the organisation, tell us about inter project fund transfer and help us in taking necessary actions.

Rahul Khanna
Project Monitoring Officer, FMSF

Kelkar Report:
A Hopeful Beginning

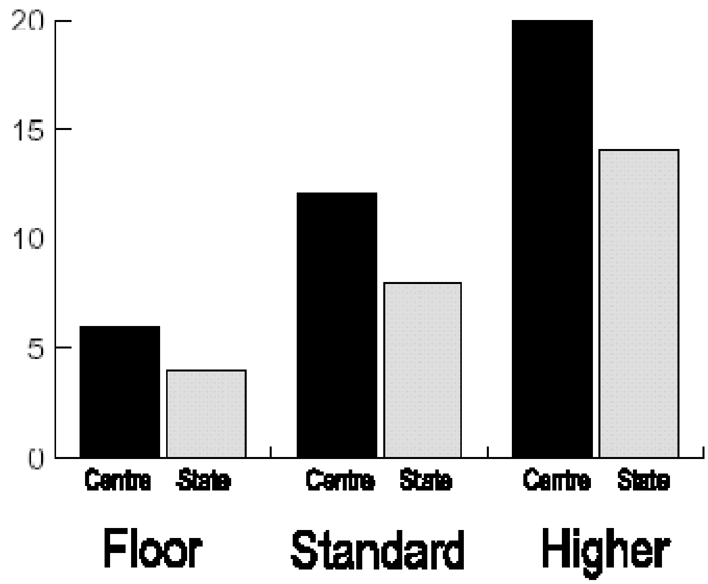
The Task Force on the Implementation of the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 presented its report in July. More widely known as the second Kelkar committee, its responsibility was to find a method to reduce the rising revenue and fiscal deficits within the country with the intention of eliminating them by the year 2008- 09. This is an amendment to the original act where revenue deficits were to be eliminated a year earlier. This hesitant start is a precursor to the difficulties that will be faced during the implementation of the Act. Though the committee provides a well-reasoned and balanced report, its implementation is likely to be filled with difficulties just like the stop-start implementation of Value Added Tax (VAT) till date.

Going through the Kelkar committee report, the broad principles are completely acceptable and welcome to all, unlike the first committee's report, which caused ripples arguing for elimination of all subsidies and the taxing of agriculture. The case for fiscal consolidation is strong with the revenue deficit of the country growing to 4.4% of GDP in 2002-03. With non-interest expenditure of government falling to just 10.7% of GDP, in 2000-01, it was beginning to affect expenditure on priority sectors like health and education. As per the FRBM Act deficit reduction at a rate of 0.5% per annum for the revenue deficit and 0.3% per annum for the fiscal deficit is suggested. Though the recommendations of the Act are welcome, the experience at the local government level suggest that such exercises are futile with laws helping to consistently widen the gap between the budgeted and actual expenditure of the government. Similar legislation in the European Union had difficulties in controlling the size of the deficits of nations within the EU.

The report uses a simple method to suggest that we do have a problem by stating clearly that in case nothing dramatic is done, the revenue deficit in 2008-09 would be of the tune of Rs. 515 billion (51,540 cr) or (1.66% of the GDP). In order to avoid a crisis, reform is suggested with emphasis on front loading of reform and that it should be through revenue enhancement and not through expenditure reduction. Front loading means that most of the changes should take place quickly as it helps build credibility of the government and also uses the current buoyancy of the economy to its advantage to facilitate a smooth transition.

In this context, the report suggests that tax reform be undertaken which aim at simplification of the tax regime and widening of the tax net. This would in turn have many benefits like reduction in distortion of economic decisions, increase the equity of the tax system and punishment of tax evaders. The proposal that is put forward is a radical one with both States and the Centre having the power to tax all goods and services under a simple Goods and Services Tax (GST). The tax will be simple and administered as shown in the figure in the next page.

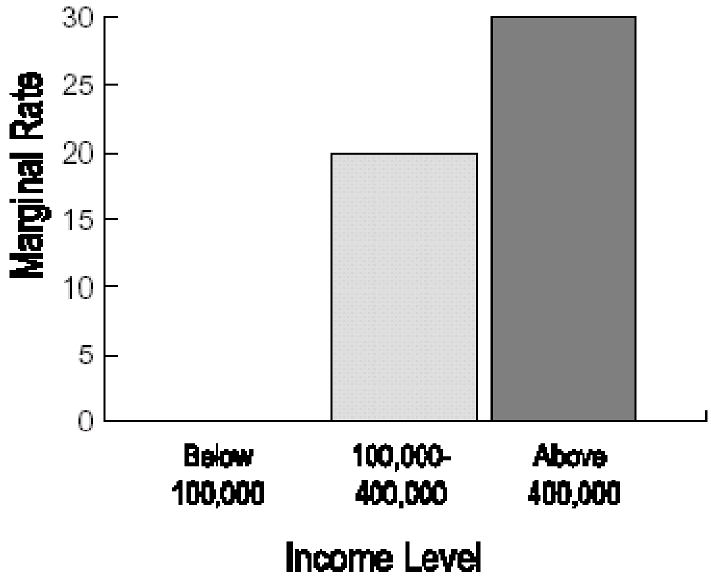
Most goods and services will be taxed at a rate of 20% which compares favourably with other nations. The panel does suggest that a list of exemptions be put in place like that in the UK where food and children's clothing are excluded from VAT. With a tax rate of 20%, poorer households (who can afford to save little) could be much worse off paying this high tax rate on food and basic necessities. This contrast is especially stark when you view the peak tax rate is just 30%.



This proposal of a GST brings the Service Sector into the tax net, which despite contributing over 50% to the GDP contributes less than 0.5% to the tax collections in the country. All other taxes and levies such as octroi, central sales tax, entry tax, stamp duties and turnover taxes will be abolished in favour of a simple tax administration. States will benefit out of this proposal as they have a greater tax base as also a carrot in terms of a portion of import duties. However, while these tax proposals are welcome, the recent experience of funding of local government through taxes like octroi are likely to suffer a setback. Like the allocation to the States, allocations to each local government should be negotiated in parallel so that conflict and unnecessary delays in the functioning of local government can be avoided.

The committee does propose that customs duties be gradually brought down to a three-tier structure of 5, 8 and 10%. On the question of income tax, the proposals have been debated many times over. The suggestions include the removal of all exemptions including those available under Section 10A, 10B, 80IA and 80IB with the simultaneous elimination of standard deduction. The carrot is that the taxable income is lower with the report going into detail of a two-tier tax structure, with an empirical study suggesting that the proposals as a package will yield lower average tax rates for all income categories.

Proposals on the corporate income tax have made the suggestion that the general depreciation rate be reduced from 25% to 15% in line with the fall in interest rates. At the same time, it has stopped short of removal of incentives for companies stating that all existing tax benefits and concessions be retained (the schemes be ‘ grandfathered’), while no new concession be given through tax exemptions. At the same time, it states that incentives are a second best solution and should not be used while instead trying to fix the structural problems with the economy (like better infrastructure, human capital etc). At the same time, the committee also focuses on a reduction in corporate tax from 35.875% to 30% in the hope that compliance will improve. This figure of 30% is higher than the effective tax rate paid (23.5%) by over 700 companies as suggested by the Business Standard Research Bureau. However, the silence of industry to these proposals suggests a quiet dissent especially in the light of lower depreciation allowances and removal of exemptions.



In order to reduce tax fraud, the committee does propose that a single common database linking customs, indirect and direct tax systems be put in place so that both the Revenue Department and the Customs Department have access to it. Through a fairly sophisticated system: Tax Information Network (TIN) a risk-based assessment is to be developed. The network will rely heavily on the training of the staff of the two departments and the adoption of good change management policies within them in order for the compliance to improve.

The expenditure part of the report is mainly recommendatory, as the first Kelkar committee has seen a quiet burial thanks to its controversial recommendations. At the same time, it has only suggested that general direction of expenditure reforms through focussing on public goods rather than subsidies. At the same time, it does talk about improved delivery through Panchayati Raj, which is not dependent on doles by State and Central government and focussing on outcomes rather than expenditure for public goods.

The likely benefits that are projected for the country include increased tax buoyancy, an intelligent tax system. At the same time, higher spends on health and education are expected with the manufacturing industry expected to get a boost especially with GST rebates for all goods exported from the country and the widening of the tax base. The assumption upon which all proposals sit on is that the simplicity of the new system combined with better monitoring mechanisms would increase compliance and hence improve tax revenue.

However, it will require a big improvement in perceived delivery of public goods for higher compliance to take place. At the same time, for people used to hand outs much on the lines of Mai Baap Sarkar, the elimination of all incentives like cheap land for industry, concessional loans for all sectors etc will require considerable political will. An alternative methodology followed in much of Europe and South East Asia, through a gradual introduction and withdrawal of different taxes in a systematic and phased manner would possibly have had more acceptance not just in the political class, but help in making the Kelkar report an implementable one.

While the Kelkar report certainly makes the right noises, it does not fully appreciate the complex interplays of decisions of this nature with politics, government, business, agriculture and other interest groups. Though each of these groups might appreciate the broad contours of the proposals, it is in the detail that the Finance Minister is likely to have his work cut out. How to package these proposals so that everybody is perceived as being better off will require more than just financial expertise. It will require the minister to walk on the tightrope of fiscal discipline while juggling balls of fire ensuring that no interest group feels marginalised or left out in the 'grand bargain' that is proposed by the Kelkar Committee.

Jacob John
Research Associate, FMSF

Alteration/ Amendment of Memorandum of Association and Rules and Regulations of the Society

In one of our previous articles we had dealt with the Memorandum of Association and the Rules and regulations of the Society under the Societies Registration Act, 1860. In the article we had dealt with the procedure and the requirements for the preparation and filing of the Memorandum and the Rules and Regulations with the Registrar of the Societies at the time of its registration.

However, a society after its registration may require at any time to change its name, or to alter, abridge or amend its objects and /or the rules and regulations at any time. A society may be required to change or alter its objects, rules and regulations at any time for any reasons or if the Government requires it. In this article we would try to deal with the requirements and the procedure for such alterations.

Alteration/ Amendment of Memorandum of Association:

The memorandum of a society contains the aims and objectives of the society within which the society has to operate. Any activity undertaken beyond the aims and objectives specified in the memorandum shall make the activity invalid. Section 12 of the Societies Registration Act 1860 gives the procedure for alteration, amendment or abridgement of the aims and objectives .The Act gives a specific procedure which is very systematic and the steps mentioned has to be adopted as given in the Act. The Section 12 in the Act is given as:

‘ Whenever it shall appear to the governing body of any society registered under this Act, which has been established for any particular purpose or purposes, that it is advisable to alter, extend, or abridge such purpose to or for other purposes within the meaning of this Act, or to amalgamate such society either wholly or partially with any other society, such governing body may submit the proposition to the members of the society in a written or printed report, and may convene a special meeting for the consideration thereof according to the regulations of the society; but no such proposition shall be carried into effect unless such report shall have been delivered or sent by post to every member of the society ten days previous to the special meeting convened by the governing body for the consideration thereof, not unless such proposition shall have been agreed to by the votes of threefifths of the members delivered in person or by proxy, and confirmed by the votes or three-fifths of the members present at a second special meeting convened by the governing body at an interval of one month after the former meeting.’

The procedure given in the Act is mandatory and not optional. In a decision of Allahabad High Court, Shridhar Mishra vs. Jaichander Vidyalankar AIR 1959, it has been stated that:

‘ It is impossible to accept the suggestion that a society is not bound by the Societies Registration Act .A private institution need not get itself registered under the Societies Registration Act. But if an institution chooses to get itself registered under the Act, the institution is bound by the provisions of the Act, whether the procedure laid down in Sec.12 of the Act is directory or mandatory is another question. But a society registered under the Act cannot altogether ignore Sec.12 of the Act.'

The proposal for alteration or extension of the purposes of the society has to be passed at the special meeting convened by a special majority of members.

Section 12 of the Societies Registration Act 1860 has laid down the following steps for alteration, extension or abridgement of the aims and objectives of a society which have to be followed:

Submission of the proposal by the governing body to the members of the society

10 days notice to members about holding of a special meeting,

convening a special meeting for the consideration of the proposal,

Approval of the proposal by 3/5th of members,

Convening second special meeting after a month, and

Confirmation by 3/5th of members present at the second special meeting.

Certain State Acts have more provisions regarding the alteration of the objects clause. Some of these provisions are:

Section 9 of the Karnataka Societies Registration Act states that the changes should be filed with the Registrar within 30 days along with a fee of Rs. 20.The order of Registrar refusing to register amendment is appealable in the court of law.

Section 11 of Madhya Pradesh Act states the circumstances in which the Registrar may order amendment of objects clause.

Section 9 of the West Bengal Societies registration Act states that the resolution should be passed by 3/5th majority. The amendments should be filed with the registrar within 30days.

Section 9 of the Telangana Area Societies Registration Act states that the resolution for the alteration is required to be voted by 2/3rd majority of members present.

Alteration / Amendment of Rules and Regulations of the Society:

The society during the course of its working may find the need to alter its rules and regulations according to the change in working of the management of the society or due to other needs felt by the management and the members. The Societies Registration Act however does not contain any provision as to the change in the rules and regulations, but it is always beneficial for the Society to follow Section 12 guidelines of the Societies Registration Act, 1860. Certain State Acts have specific provisions in their respective State Societies Registration Act for alteration of the rules and regulations of the society. Some of the provisions specifically given in these state acts are:

> Section 4 A of the Bihar Societies Registration Act states that a corrected copy of the rules and regulations certified by at least three members of the governing body should be sent to the inspector general of Registration
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> Section 4A of the Gujarat (Amendment) Societies Registration Act and U.P. Societies Registration (Amendment) Act states that the corrected and certified copy of the rules should be sent to the registrar within 30 days of alteration.
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> Section 4A of the Orissa Societies Registration(Amendment) Act states that a certified and corrected copy of the rules should be sent to the registrar within 2 months of the alteration
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> Section 4 A(6) of Pondicherry Societies Registration(Amendment) Act states that a certified and corrected copy of the rules should be sent to the registrar within 15 days of the alteration
>
> Section 10 of the Karnataka Societies Registration act states that resolution is to be passed for the amendment by 3/5th of the majority. The corrected and certified copy of the rules should be sent to the registrar within 30 days of alteration with a fee of Rs.10 along with it.
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> Section 4A of the Gujarat(Amendment) Societies Registration Act and Section 8(3) of West Bengal Societies Registration Act states that the corrected and certified copy of the rules should be sent to the registrar within 30 days of alteration
>
> Section 4A of the Assam (Amendment) Societies Registration Act states that a corrected copy of the rules and regulations certified by at least three members of the governing body should be sent to the registrar
>
> Section 11 & 15 of the Madhya Pradesh Societies Registration Act states that the alteration should be registered with the registrar and gives the circumstances under which amendment can be ordered by the registrar.

Change of name of the Society

During the course of its working the members of the society might feel a need to change the name of their society; however, the Societies Registration Act 1860 does not specify any specific procedure for change of the name of the society. For the change of the name, the society has to follow the same procedure which has been laid down in the Act under Section 12. However certain State Governments have inserted amendments in the Societies Registration Act giving procedure for change of name, specifying how the society can change the name by passing a resolution in the General meeting with consent of appropriate majority of its members.

In general, various State Acts under section 12, 12A, 12B give the following procedure for change of the name of the society:

Convene a general meeting for the purpose of the change of the name

A resolution should be passed by a majority

The notice in writing of the change of name, which has to be signed by the Secretary of the society along with seven members(as in case of the registration of the memorandum of association), should be submitted to the registrar.

The name of the society if accepted by the registrar is registered and the change of name is effected from the date of the registration. However the registrar may refuse to register the change of name in case the name proposed is identical to some other society or for reasons that the name may be deceiving to the public or the name suggests patronage of Government or connection with any body constituted by the Government or any other authority. The change of name does not affect any legal proceedings which are already present for the society.

Various State Governments have provisions related to change of name inserted in the Societies registration Act like:

Section 12 of Delhi (Amendment) Act, Goa, Diu and Daman(Amendment)Act, Himachal Pradesh (Amendment)Act state that the resolution should be adopted by 3/5th of the majority.

Section 12A 12B, 12C of Bihar (Amendment) Act, Gujarat (Amendment) Act, Maharashtra (Amendment) Act, Pondicherry (Amendment) Act, Orissa (Amendment) Act state that the resolution should be passed by 3/5th majority.

Gujarat (Amendment) Act, Maharashtra (Amendment)Act, Orissa (Amendment) Act also specify that the resolution after being adopted by 3/5th of majority should be confirmed at a subsequent meeting and a certified copy of change in name should be obtained from the registrar on payment of fees of Re.1.

Section 12, 12A, 12B, 12C of Assam (Amendment) Act, Nagaland (Amendment) Act, U.P. Amendment Act, M.P. Act, Rajasthan Act state that the resolution should be adopted by 2/3rd of the majority.

Tamil Nadu Act states that the resolution should be adopted by 3/4th of the majority.

To be continued ... ...

Pooja Bagga
Project Monitoring Officer, FMSF