

Legal Update

February 16, 2009

INTERIM BUDGET 2009: "TAX RATES MUST FALL", SAYS FM

These are truly testing times. Within a very short period India may have seen it all: from what initially seemed like an economic boom to the downward spiral of recession, eroding credit, bankruptcies, failure of corporate governance, stagnation in industrial growth, ground level inequities and the dark hand of terrorism.

Against this backdrop and with a view to meet the projected expenditure for the first 4 months of the next financial year after which the term of the current government would come to an end, the Finance Minister of India has today laid before the Parliament for a vote on account, the interim budget for the year 2009-10.

Recognizing the impact of the global economic crisis on India, the Government has relaxed the Fiscal Responsibility and Budget Management targets set out in the earlier budget. The fiscal deficit is expected to go up to 6% of the GDP. Notwithstanding this, the policy behind the interim budget may be easily inferred from the Finance Minister's reference to Prof. Amartya Sen's suggestion of supplementing 'growth with equity' with a commitment towards 'down turn with security' in the light of recent global socio-economic trends.

The Government has increased the budgetary allocation towards rural infrastructure. A number of reforms have been suggested on the social welfare front, which include employment generation and increased access to education for weaker sections, subsidies in relation to essential commodities, enhanced disbursement of low cost credit to labour intensive sectors. An increase in the allocation for defence has also been proposed.

However, the absence of any significant fiscal sector reforms is likely to raise several concerns. Admitting that "[i]n the days of financial stress, tax rates must fall and our ability to pay taxes must rise", the Finance Minister highlighted some of the reforms carried out over the course of the last four years, which included rationalization of direct and indirect tax rates, expansion of the tax base, modernization of the tax enforcement machinery and other administrative reforms. The Finance Minister also alluded to the economic stimulus package announced in December 2008 and January 2009 for bringing about certain reforms in the tax regime. However, being an interim budget, the Government seems to have abstained from suggesting any changes in the existing direct and indirect tax framework.

Many industrial players have voiced their expectations on the ushering in of sector specific tax incentives and other fiscal reforms through the interim budget. The Government, while noting that tax rates should fall further, has desisted from bringing about any such changes, leaving it for the newly elected government to take such decisions.

One may in fact discern a clear difference in the approach of the Indian Government to reduce taxes, and that proposed by the new Obama-led government in the United States which is poised towards increasing the tax rates. Given that democracies around the world are now directed by the common object to ensure stable growth and development, we will have to wait and see how our policies shall get us there.

- The International Tax Team

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