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RESEARCH

Budget: Quick views

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Market has corrected sharply to budget

We will come out with a more detailed note once we have read the fine print. Eg we are not yet clear regarding the tax benefit on Reliance's gas production. Meanwhile, our view that the market was due for a 10-15% correction due to stretched valuations and unrealistic expectations on reforms in the budget seems to be playing out in the market correction.

Borrowing higher than expected – bond yield to go up

The Government has projected fiscal deficit at 6.8% of GDP lower than our assumed 7.2%. At the same time, borrowing has jumped by Rs890bn (even above our above-consensus Rs600bn) due to lower than expected PSU divestment proceeds. This leads us to push our 10y forecasts up to 7.5% (from 7%) as on March 2010.

Key gainers – ITC, M&M,

ITC: No increase in excise duty in cigarettes is a very positive development in our view. We see upside potential to our earnings estimate since our model was incorporating a 5% increase. This should help resurrect volume growth which has been declining for the last two years. We do highlight that VAT (levied through State Budgets) has increased from 12.5% to 20% in two States (Maharashtra and New Delhi) and Budgets are still due in 6 States. Currently the Excise saving far outweighs the VAT increase in Maharashtra and New Delhi. It is unlikely that all the remaining States will increase VAT and hence we believe there is upside potential to our earnings forecasts.

M&M: M&M's UVs will now bear a lower excise of Rs 15,000 (instead of Rs 20,000), over and above the applicable excise rate of 20%. UVs (where engine displacement is >2L) account for ~40% of the company's sales, and the company could benefit if this is not passed to consumers. We estimate 3-4% increase in FY10E core EPS.

IT Services: The income tax holiday on software and software services exports under Sec 10 A has been extended by only one year, until Mar 2011. There is no extension for units that have completed 10 years from setting up. Our first cut expectation is that HCL Technologies, Tech Mahindra (standalone) and Patni are three companies that should benefit.

MAT increase is a negative

We believe increase in MAT would be negative for companies like Bharti, R-Com, Idea, Reliance Ind, Cairn. We estimate MAT will increase the tax outgo of all infrastructure projects and reduce the DCF values by ~3% (Reliance Infra, Jaiprakash, IVRCL etc are affected in our view).

Table 1: Budget09 injects 0.5% of GDP stimulus

Item/Rsbn	FY07	FY08	FY09	FY10 E	FY10 E
1.Revenue receipts	4337	5186	5447	6145	5657
Tax revenue	3515	4352	4477	4742	4497
Non-tax revenue	822	835	969	1403	1160
2. Non-debt capital receipts	64	435	67	53	308
Recovery of loans	59	15	62	42	97
Other receipts	5	417	5	11	211
3. Total receipts (1+2)	4402	5622	5514	6198	5965
4. Non-plan expenditure	4130	5032	6060	6957	7000
4.1 On revenue account	3716	4107	5565	6188	6300
4.1.1of which: Interest payments	1496	1667	1905	2255	2144
4.2 On capital account	413	925	495	769	700
5. Plan expenditure	1700	2059	2755	3251	3065
5.1 On revenue account	1425	1752	2352	2784	2660
5.2 On capital account	276	308	403	467	405
6. Total expenditure (4+5)	5829	7092	8815	10208	10065
7. Gross fiscal deficit (6-3)	1427	1470	3301	4010	4100
% of GDP	3.4	3.1	6.2	6.8	7.2

Source: Banc of America Securities-Merrill Lynch Research

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Budget Highlights

Macro Economics

- The fiscal deficit as a percentage of GDP is projected at 6.8% compared to 2.5% in BE 2008-09 and 6.2% as per provisional accounts 2008-09.
- Proposal to continue the interest subvention scheme for short term crop loans to farmers for loans upto Rs.3 lakh per farmer at the interest rate of 7% per annum. Government shall also pay an additional subvention of 1% as an incentive to those farmers who repay their short term crop loans on schedule.
- Total expenditure in B.E. 2009-10 increased by 36% over B.E. 2008-09.
- Subsidies up from Rs.71,431 crore in B.E. 2008-09 to Rs.1,11,276 crore in B.E. 2009-10.

Taxes and Duties

Direct Taxes

- No changes made in the Corporate Tax rates.
- Exemption limit in personal income tax raised by Rs.15,000 from Rs.2.25 lakh to Rs.2.40 lakh for senior citizens; by Rs.10,000 from Rs.1.80 lakh to Rs.1.90 lakh for women tax payers; and by Rs.10,000 from Rs.1.50 lakh to Rs.1.60 lakh for all other categories of individual taxpayers.
- Surcharge on various direct taxes to be phased out; in the first instance, by eliminating the surcharge of 10 percent on personal income-tax.
- Sun-set clauses for deduction in respect of export profits under sections 10A and 10B of the Income-tax Act being extended by one more year.
- Fringe Benefit Tax on the value of certain fringe benefits provided by employers to their employees to be abolished.
- Scope of provisions relating to weighted deduction of 150% on expenditure incurred on in-house R&D to all manufacturing businesses being extended except for a small negative list.
- Minimum Alternate Tax (MAT) to be increased to 15 per cent of book profits from 10 per cent. The period allowed to carry forward the tax credit under MAT to be extended from seven years to ten years.
- Commodity Transaction Tax (CTT) to be abolished.
- Tax holiday under section 80-IB(9) of the Income Tax Act, which was hitherto available in respect of profits arising from the commercial production or refining of mineral oil, to be extended to natural gas. This tax benefit to be available to undertakings in respect of profits derived from the commercial production of mineral oil and natural gas from oil and gas blocks which are awarded under the NELP-VIII round of bidding. The section to be retrospectively amended to provide that “undertaking” for the purposes of section 80-IB(9) will mean all blocks awarded in any single contract.

Indirect Taxes

Custom Duties

- Customs duty of 5% to be imposed on Set Top Box for television broadcasting.
- Customs duty on LCD Panels for manufacture of LCD televisions to be reduced from 10% to 5%.
- Full exemption from 4% special CVD on parts for manufacture of mobile phones and accessories to be reintroduced for one year.
- List of specified raw materials and equipment imported by manufacturer-exporters of leather goods, textile products and footwear industry which are fully exempt from customs duty, subject to specified conditions, to be expanded.
- Customs duty on 10 specified life saving drugs/vaccine and their bulk drugs to be reduced from 10% to 5% with Nil CVD (by way of excise duty exemption).
- Customs duty on specified heart devices, namely artificial heart and PDA/ASD occlusion device, to be reduced from 7.5% to 5% with Nil CVD (by way of excise duty exemption).
- Customs duty on permanent magnets for PM synchronous generator above 500 KW used in wind operated electricity generators to be reduced from 7.5% to 5%.
- Customs duty on bio-diesel to be reduced from 7.5% to 2.5%.
- Customs duty on 'mechanical harvester' for coffee plantation to be reduced from 7.5% to 5%. CVD on such harvesters has also been reduced from 8% to nil, by way of excise duty exemption.
- Customs duty on serially numbered gold bars (other than tola bars) and gold coins to be increased from Rs.100 per 10 gram to Rs.200 per 10 grams Customs duty on other forms of gold to be increased from Rs.250 per 10 gram to Rs.500 per 10 gram. Customs duty on silver to be increased from Rs.500 per Kg. to Rs.1000 per Kg. These increases also to be applicable when gold and silver (including ornaments) are imported as personal baggage.
- Customs duty on cotton waste to be reduced from 15% to 10%.
- Customs duty on wool waste to be reduced from 15% to 10%.
- Customs duty on rock phosphate to be reduced from 5% to 2%.
- Customs duty exemption on concrete batching plants of capacity 50 cum per hour or more to be withdrawn. Such plants will now attract customs duty of 7.5%.
- On packaged or canned software, CVD exemption to be provided on the portion of the value which represents the consideration for transfer of the right to use such software, subject to specified conditions.

Excise Duties

- Excise duty rate on items currently attracting 4% to be raised to 8% with few major exceptions.
- Specific component of excise duty applicable to large cars/utility vehicles of engine capacity 2000 cc and above to be reduced from Rs. 20,000/- per vehicle to Rs.15,000 per vehicle.
- Excise duty on petrol driven trucks/lorries to be reduced from 20% to 8%. Excise duty on chassis of such trucks/lorries to be reduced from ‘20% + Rs.10000’ to ‘8% + Rs.10000’.
- Excise duty on Special Boiling Point spirits to be reduced to 14%.
- Excise duty on naphtha to be reduced to 14%.
- Duty paid High Speed Diesel blended with upto 20% bio-diesel to be fully exempted from excise duties.
- The *ad valorem* component of excise duty of 6% on petrol intended for sale with a brand name to be converted into a specific rate. Consequently, such petrol would now attract total excise duty of Rs.14.50 per litre instead of ‘6% + Rs.13 per litre’.
- The *ad valorem* component of excise duty of 6% on diesel intended for sale with a brand name to be converted into a specific rate. Consequently, such diesel would now attract total excise duty of Rs.4.75 per litre instead of ‘6% + Rs.3.25 per litre’.
- Excise duty on manmade fibre and yarn to be increased from 4% to 8%.
- Excise duty on PTA and DMT to be increased from 4% to 8%.
- Excise duty on polyester chips to be increased from 4% to 8%.
- Excise duty on acrylonitrile to be increased from 4% to 8%.
- The scheme of optional excise duty of 4% for pure cotton to be restored.
- Excise duty for man-made and natural fibres other than pure cotton, beyond the fibre and yarn stage, to be increased from 4% to 8% under the existing optional scheme.
- An optional excise duty exemption to be provided to tops of manmade fibre manufactured from duty paid tow at par with tops manufactured from duty paid staple fibre.
- Suitable adjustments to be made in the rates of duty applicable to DTA clearances of textile goods made by Export Oriented Units using indigenous raw materials/ inputs for manufacture of such goods.
- Excise duty exemption on ‘recorded smart cards’ and ‘recorded proximity cards and tags’ to be made optional. Manufacturers have the option to pay the applicable excise duty and avail the credit of duty paid on inputs.
- EVA compound manufactured on job work for further use in manufacture of footwear to be exempted from excise duty.

- On packaged or canned software, excise duty exemption to be provided on the portion of the value which represents the consideration for transfer of the right to use such software, subject to specified conditions.
- Excise duty on branded articles of jewellery to be reduced from 2% to Nil.

Service Tax

- Service Tax to be imposed on the following services:
  - Service provided in relation to transport of goods by rail
  - Service provided in relation to transport of coastal cargo; and goods through
  - Inland water including National Waterways
  - Advice, consultancy or technical assistance provided in the field of law (this tax would not be applicable in case the service provider or service receiver is an individual).
  - Cosmetic and plastic surgery service
- Exemption from service tax being provided to inter-State or intra-State transportation of passengers in a vehicle bearing 'Contract Carriage Permit' with specified conditions.
- Exemption from service tax (leviable under Banking and other financial services or under Foreign exchange broking service) being provided to inter-bank purchase and sale of foreign currency between scheduled banks.
- Two taxable services, namely, 'Transport of goods through road' and 'Commission paid to foreign agents' to be exempted from the levy of service tax, if the exporter is liable to pay service tax on reverse charge basis. However, present cap of 10% on commission agency charges is retained. Thus there would be no need for the exporter to first pay the tax and later claim refund in respect of these services.
- For other services received by exporters, service tax exemption to be operated through the existing refund mechanism based on self-certification of the documents where such refund is below 0.25 per cent of FOB value, and certification of documents by a Chartered Accountant for value of refund exceeding the above limit.
- Export Promotion Councils and the Federation of Indian Export Organizations (FIEO) to be exempt from service tax on the membership and other fees collected by them till 31st March 2010.

Others

- Defense spending to go up by 34%.
- Allocation for NREGA increased of 144% over 2008-09 Budget Estimates.
- Allocation for Bharat Nirman increased by 45 per cent in 2009-10 over B.E. 2008-09. Allocations under Pradhan Mantri Gram Sadak Yojana (PMGSY) increased by 59 per cent over B.E. 2008-09 to Rs.12,000 crore in B.E. 2009-10.

- Under Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY), allocation increased by 27 per cent to Rs.7,000 crore.

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