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BUDGET 2020: A BUDGET FOR REVIVAL AND REFORM?

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In a few days, our Finance Minister (FM) will be presenting the Union Budget in the backdrop of not just a slowdown in the economy, but also falling direct tax revenues compared to FY 2019 (if collection trends till 15 January were to continue), with the latter being a first in the past 20 years.

The Budget will nevertheless be expected to tick the box on measures that provide a stimulus to the economy - greater consumer spending, ushering more investment and rationalisation of the taxation framework.

Fiscal constraints, however, would require the FM to be prudent in loosening the purse strings, reserving it for those sectors that need immediate support and the ones that would contribute the most in revival of the economy.

Some of the anticipated changes that will be a shot in the arm for taxpayers include:

1. Reviving the real estate sector: One sector which certainly requires immediate intervention is the real estate sector, with housing demand and credit flow to the sector requiring urgent fixing. Doubling the interest deduction and principal deduction on housing loans given under the Income-tax Act from the present Rs. 2 lacs and Rs. 1.5 lacs respectively, to Rs. 4 lacs each, may help boost housing demand and credit uptake. While the previous Budget provided incentives in the affordable housing segment, redefining an 'affordable housing' project from the present stamp duty value (which provides for an upper limit of Rs. 45 Lacs per housing unit, an unrealistic threshold in many tier-1 cities) to a pragmatic area-based threshold could enlist more takers for the incentive provisions.

2. Boosting rural consumption: In recent times, rural India has witnessed a decline in consumption and an increase in unemployment. The propensity to consume among those at the bottom of the pyramid is higher, and therefore, increasing allocations for MGNREGA, providing fiscal incentives for upgrading rural infrastructure and other measures that augment rural consumption may have positive multiplier effects on the economy.

3. Accelerating taxation reforms: Having begun the journey of corporate tax reform with the recent corporate tax rate cut, the momentum must continue by doing away with the Dividend Distribution Tax (DDT). This would hopefully leave more income in the hands of companies for investment, ensure tax recipients are taxed at rates appropriate to each shareholder, and provide relief to foreign investors who do not get credit in their country of residence for DDT paid by Indian companies.

Importantly, the 'buyback tax', that is, tax on buyback paid by companies (akin to the DDT, with the shareholder not paying any tax), was ostensibly introduced to bring the taxation framework for buyback on par with dividend. If the DDT is abolished, the Government must also phase out the buyback tax. This would give companies the freedom to choose the best way of returning surplus to shareholders (without being compelled by tax considerations) and phasing out both DDT and buyback tax will greatly boost market sentiment.

4. Assuaging investor concerns: India continues to attract foreign investment and certainly needs increased inflows to achieve the $5 trillion economy goal. However, uncertainty in tax policy and protracted litigation are anathema to foreign investment. India introduced the General Anti-Avoidance Rule (GAAR) with effect from FY 17-18 and has empowered the tax authorities to deny tax benefits when the 'main purpose' of an arrangement is to avoid tax. Last year, India also ratified the Multilateral Instrument (MLI) as part of the OECD's BEPS project, which allows for denying a tax-treaty benefit even if one of the principle purposes of the arrangement was to obtain treaty benefit (the principle purpose test or 'PPT'). However, in the absence of effective guidance by the tax authorities, especially regarding the PPT, foreign investors are concerned about the impact of these developments to their investments in India, particularly from low-tax regime countries. Budget 2020 must therefore provide guidance and a de minimus threshold in order to invoke the PPT. Furthermore, in cases where PPT is sought to be invoked in order to deny any benefit, the matter must first be referred to a panel (as in the case when GAAR is invoked), and only after a decision from the panel must PPT be invoked.

5. Tax disputes resolution scheme: Fiscal consolidation has been one of the key achievements of the Government since 2014. Resource mobilization through a legacy dispute resolution scheme for direct taxes, on the lines of the ' Sabka Vishwas, Sabka Vikas' scheme for indirect taxes, has the potential to mop-up significant amount of revenue and reduce the quantum of pending cases clogging our judicial system.

6. Expediting resolution mechanisms: The Task Force on Direct Taxes (chaired by Mr. Akhilesh Ranjan) recently submitted the draft of a new direct tax law. Its recommendations include, among others, the introduction of mediation as a mechanism for settling tax disputes. While the recommendation is forward-looking and must be seriously considered, it should be borne in mind that the Government must commit adequate resources, in terms of manpower and infrastructure, to existing as well as future forums for tax dispute resolution. A case in point is the Authority for Advance Ruling (AAR), a forum to provide rulings in advance on the tax liability of non-residents. While the forum is statutorily mandated to provide a ruling within 6 months, inadequate number of members to deal with the applications and untimely filling of vacancies have led to an increase in the average time for disposal of applications to 3-4 years.

All in all, Budget 2020 will be keenly observed to see how far the Government is willing to sacrifice fiscal prudence for giving the Indian economy a much-needed stimulus, and the extent of reforms that the Government intends to pursue in its second term.

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