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In this
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Foreword



Sameer Gupta
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India's budget for the next fiscal aims to build on the foundation laid in the last one to propel the country into Amrit Kaal. Presented against the backdrop of global recessionary trend and continued geo-political uncertainties, the budget focuses substantially on domestic growth drivers combined with tech-enabled empowerment of all deserving sectors. The biggest plus is the continued push to government's capital expenditure. With 33% capex growth planned in FY24 taking the total outlay to INR10 trillion, it will be a game changer for crowding in the private sector investments. Together with the grants to states to increase their capex, the effective capital expenditure is estimated at 4.5% of GDP in FY24. The multiplier impact of such investments can be substantial. The Government of India has managed the increased outlays while firmly adhering to the fiscal consolidation path, which is commendable.

India has shown leading growth across the major global economies this fiscal. Budget 2023 presents a solid roadmap for this continued trajectory with guiding principles set around inclusion and sustained growth.

On the tax front, Finance Minister Ms. Nirmala Sitharaman has focused on stability and, with this objective,

deferred some of the widely expected simplification proposals. Another visible thread is the rationalization of financial instruments giving tax benefits, especially to HNIs. This is reflective in gains from transfer / redemption of Market Linked Debentures now deemed as short-term capital gains, long-term capital gains deduction for investment in residential house property restricted to INR10 crores, and life insurance policies with aggregate annual premium of more than INR5 lakhs made taxable.

The Budget continues its earlier trend of plugging loopholes and broadening the TDS scope. Taxpayers have been disappointed with the decision to not extend the sunset dates in respect of setting up new manufacturing companies for lower (17.2%) corporate tax rate and lower withholding tax on external commercial borrowings and rupee denominated bonds and debt investments by FPIs. In view of the recent geo-political uncertainties, an extension would provide some more room for considering fresh investments. Businesses still hope for an extension of the sunset date at the stage of enactment of Finance Bill, 2023.

In line with global trends to simplify personal tax compliances while allowing for simple standard and

pension deductions, the Budget makes the concessional tax regime as the default option. The move will leave more in the hands of citizens and encourage greater consumption and investments.

The 'angel tax' scope has widened and private companies, including start-ups, while raising capital from foreign investors, will need to be mindful of the fair value to avoid tax implications. GIFT IFSC (International Financial Services Centre) is a key initiative by the Government with several key policy announcements being made in this Budget as well.

Customs duty changes are aimed to encourage exports, green energy and domestic manufacturing. The emphasis on encouraging formalisation of the economy by penalising cash transactions / unregistered entities continues in this Budget.

This issue of 'EY India Tax Insights' covers the above themes, and more. We hope it helps you understand the key policy drivers that are affecting businesses in India.

As always, we look forward to your feedback and suggestions.

In this issue





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This article is co-authored by C.Rangarajan, Former Chairman, Prime Minister's Economic Advisory Council and Former Governor, Reserve Bank of India, and D.K.Srivastava, Chief Policy Advisor, EY India and Former Director, Madras School of Economics.

Fiscal consolidation in India: charting a credible glide path

- Introduced in 2003, the Fiscal Responsibility and Budget Management Act (FRBMA) aims to keep fiscal deficit under check.
- India's fiscal deficit to GDP ratio peaked during pandemic.
- The government is persistently working towards reducing fiscal deficit, as seen in Budget 2023 as well.

Fiscal consolidation so far: success and failures

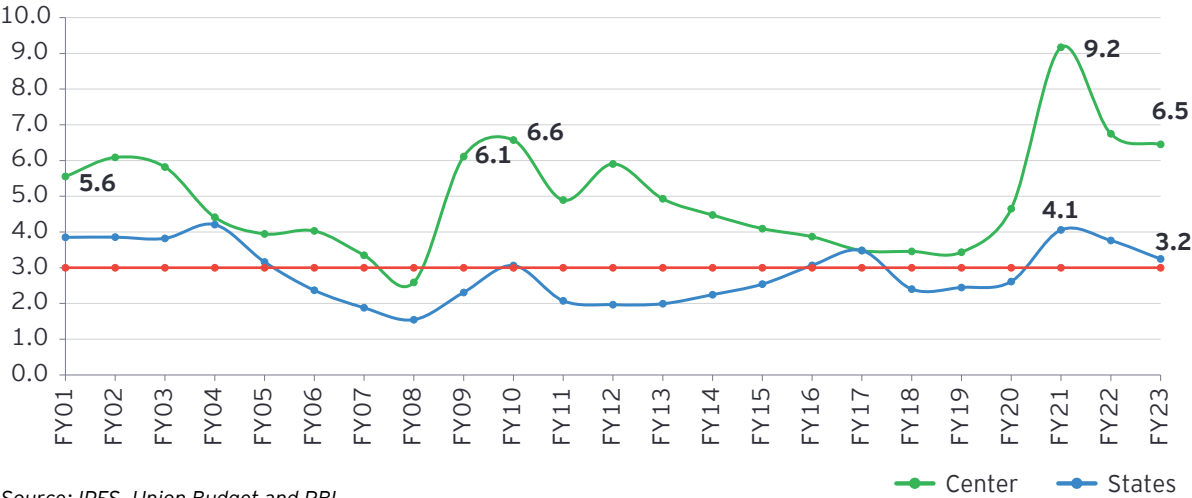
The Government of India in 2003 enacted the Fiscal Responsibility and Budget Management Act (FRBMA), which focused on reducing the fiscal deficit of the country. However, it was only in FY08 when the fiscal deficit was brought below 3%. States, who enacted their individual Fiscal Responsibility Legislations (FRLs) from 2002 to 2010 considered together,

were more successful in keeping their fiscal deficit below 3% in many years.

Bringing union government's revenue account in balance or surplus was also the part of the 2003 FRBMA and was hence, endorsed by the Twelfth Finance Commission. It became a feature of states' FRLs. However, in the 2018 amendment to the union

government's FRBMA, revenue account balance as an objective was given up. The amended Act specified the debt-GDP targets for the union government, states and their combined accounts at 40%, 20% and 60% respectively while the fiscal deficit to GDP targets were kept at 3% each for the union government and aggregate of states.

Chart 1: Fiscal deficit relative to GDP: union government and states



Source: IPFS, Union Budget and RBI

Note: (1) +ve indicates a deficit and -ve indicates a surplus. (2) Fiscal deficit-GDP ratios have been estimated by using NSO's latest GDP data released on 28 February 2023. (3) States' fiscal deficit for FY22 and FY23 is as per the RE and BE from RBI. Centre's FY23 fiscal deficit is as per the RE given in the FY24 Union Budget.

COVID-19-induced slippages

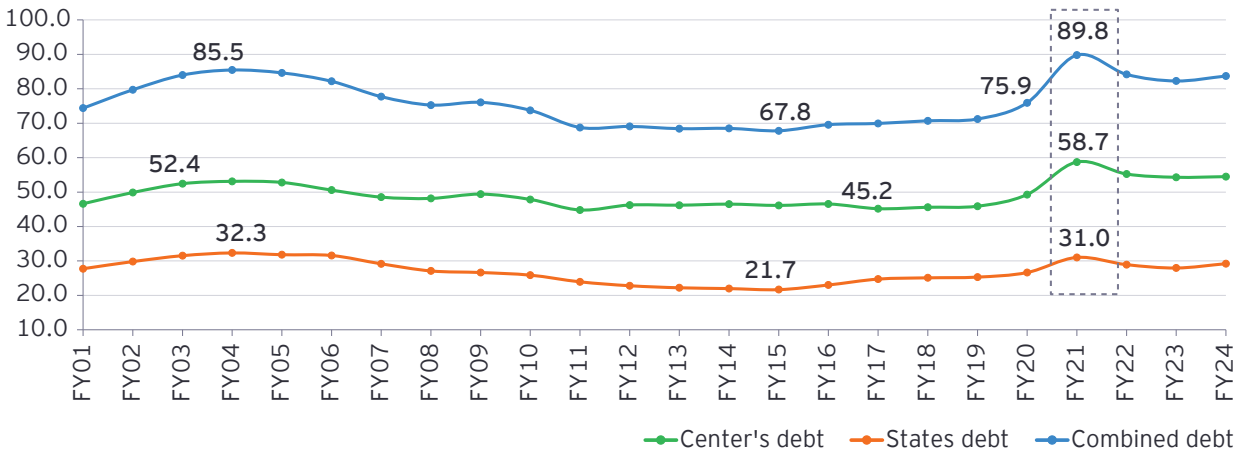
Chart 2 shows the profiles of the debt-GDP ratio of the central and state governments and on their combined account. The combined debt-GDP ratio had peaked in FY04 at 85.5%. It fell to 67.8% in FY15 after which it increased progressively to 75.9% by FY20.

With the onset of COVID-19 in FY21, India experienced a negative growth of

(-)5.7% as per NSO's second advance estimates. Even the nominal growth in this year was negative at (-)1.2%. This resulted in a major deterioration in the debt-GDP ratios across the board. The consolidated debt-GDP ratio increased sharply to close to 90% with union government's debt-GDP ratio (excluding any on-lending to

states with external debt estimated at the current market exchange rate) at 58.7% and that of states at 31%. The combined debt-GDP ratio exceeded the benchmark by nearly 30% points. Union government's fiscal deficit to GDP ratio in the COVID-19 year peaked at 9.2%, well in excess of the operational target of 3%.

Chart 1: Fiscal deficit relative to GDP: union government and states



Source (basic data): IPFS, MoF, Union Budget FY24

Note: (1) Centre's net liabilities excludes all on-lending to states. It includes external debt estimated at the current market exchange rate. (2) The combined debt-GDP ratio is the sum of central net liabilities excluding all on-lending to states and states' liabilities.

Union government's FY24 Budget: charting a credible glide path

The union budgets post FY21, with positive growth rates and some effort at fiscal consolidation, resulted in a fall in the union government's fiscal deficit to GDP ratio to 6.8% and 6.5% in FY22 and FY23, respectively. This effort was strengthened in the FY24 budget, where in spite of global economic headwinds, central government persisted with

fiscal consolidation. Compared to a reduction of 0.3% points in FY23, the budgeted reduction in the fiscal deficit-GDP ratio in FY24 is 0.5% points, which according to present indications is further to be accelerated to an annual reduction of 0.7% points in the next two years, enabling a fiscal deficit level of 4.5% of GDP by FY26 (Table 1). In FY24 budget,

the union government is focused on capital expenditure growth (37.4%) while limiting revenue expenditure growth to 1.2% with a view to taking advantage of the high capital expenditure multiplier. According to RBI (2019), union government's capital expenditure peak multiplier was estimated at 3.25 while that of revenue expenditure is 0.45.

Table 1: Union government's debt and fiscal deficit relative to GDP (%): glide path

Item	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26
Nominal GDP growth	11.0	10.6	6.2	-1.2	18.4	15.9	10.5	11.0	11.0
Fiscal deficit-GDP ratio	3.5	3.4	4.7	9.2	6.8	6.5	5.9	5.2	4.5
Debt-GDP ratio	45.6	45.9	49.3	58.7	55.1	54.1	54.5	54.3	53.5

Source (basic data): Union Budget FY24 and NSO

Notes: (1) GDP magnitudes up to FY23 are as per the latest NSO release (28 February 2023). For FY24, budgeted nominal growth of 10.5% is used. For subsequent years, a nominal growth of 11% is used. (2) In calculating Centre's debt, any on lending from Centre to states is not included and external debt is evaluated at market exchange rates. (3) Debt-GDP numbers may not tally with the numbers given in the Union Budget due to adjustments mentioned in notes (1) and (2)

Government borrowing is a pre-emptive claim on the economy's available investible resources. In India, it is only the household sector which has an investible surplus in the form of financial savings which presently amount to 8% of GDP. Supplementing this by a net capital inflow from abroad of nearly 2.5% of GDP, total investible resources add to 10.5% of GDP. In FY24, the combined fiscal deficit of central and state governments may amount to 9.4% of GDP, leaving limited scope for borrowing by the private sector and the PSUs. As combined fiscal deficit is brought down, progressively more investible resources would become

available for the private sector. In the years after FY26, union government's fiscal deficit may be allowed to fall by higher margins of say 0.75% points of GDP per year with a view to reaching the FRBM target in the next two years.

By FY28, a fiscal deficit-GDP ratio of 3% would be reached, but according to our estimates, assuming a nominal growth of 11%, the debt-GDP ratio would be close to 50%, 10% points above the FRBM target. Continuing with an 11% nominal growth and retaining a fiscal deficit-GDP level of 3%, the debt-GDP ratio is expected to reach 40% by FY35. As government debt as a proportion of GDP falls, the

effective interest rate on government debt would also fall, reducing the interest payment to revenue receipts ratio, thereby facilitating the accelerated pace of reduction in fiscal deficit for reaching the desired target. If the implicit price deflator-based inflation is kept at 4%, a real GDP growth of 6.7% would be required over this period. Sustaining a growth rate at this level would require a suitable growth in private investment. It is only achieving the FRBM norms and adherence to these over a long period that would leave enough investible resources for the private sector to contribute to growth.

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