



INDIA

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# India Budget 2008

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# India

## Budget 2008

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# Foreword

The Finance Minister presented the Union Budget in Parliament today under the dark shadow of recessionary clouds that have so ominously gathered over the global economic landscape in recent months. The Indian economy itself has stayed reasonably strong and buoyant over the last year, despite the export sector being deeply impacted by the fairly dramatic appreciation in the Indian currency. The country's GDP expanded by 8.7% in the current year, and has increased by almost 9% over the last three years, a truly impressive performance. The services sector continues to power GDP expansion, while the agricultural sector has registered a disappointing year. Though the industrial sector has expanded at a respectable pace over the last year, there are clear signs of slowdown in recent quarters.

The Government has outperformed its FRBMA commitments on revenue and fiscal deficit. The deficits stand at 1.4% and 3.1% respectively, an improvement over the Government's beginning-of-year projections of 1.5% and 3.3% respectively. 26 of the 28 states in India have introduced their own FRBMA legislation, and there has been a significant improvement in state finances over the last year. In the next year, the Central Government expects to reduce its revenue and fiscal deficit further to 1% and 2.5% respectively. The strong growth in tax revenues, particularly direct tax revenues, has helped the country's Tax-to-GDP ratio climb to 12.5%. The increasing proportion of direct tax revenues in the total tax revenues reflects a directional trend towards greater equity and social equilibrium in the taxation system.

In these relatively prosperous circumstances, and given that this Budget is the incumbent Government's final, full-year Budget before the next national elections, some trace of populism in budgetary allocations and social expenditure commitments was almost inevitable. Quite expectedly, the Finance Minister announced hefty allocations towards the health, education and agricultural sectors. The mammoth debt waiver and one-time settlement scheme for outstanding agricultural loans, admittedly for fine and compassionate reasons, cannot but have some residual negative impact on broader macro-economic sentiment. The UPA Government's flagship social expenditure programmes continue to be vested with handsome budgetary allocations, and one hopes that there is some improvement in the deployment efficiency of these schemes. There was surprisingly less visible emphasis on the

infrastructure sector, a pet theme in most Union Budgets, in the Finance Minister's speech.

On the taxation side, given the buoyancy in revenues, there were expectations that the education cess and surcharge embedded in the effective income-tax rate would be partially or cumulatively removed. The Finance Minister did not oblige. Quite unexpectedly, the short term capital gains tax rate has been increased to 15%. The proposal to offer credit to underlying DDT in a two-tier parent/ subsidiary corporate structure is a welcome move, though the fine print does not seem to have been worded as benevolently as the concept itself. Some fiscal incentives targeted for research activity, through weighted deductions, have been proposed. Fiscal incentives have also been proposed for the healthcare and hospitality sector. Some minor relief to the FBT rules has been conceived. On personal income-taxes, the generous increase in the threshold exemption limit to Rs 150,000 is a good move, and reflects the Government's improved comfort with the scale and quality of tax compliance in the country today. No substantive changes have been proposed to the STT levy; a comparable levy has been introduced for commodities trading. The BCTT will be abolished with effect from April 2009.

On indirect taxes, no change has been proposed to the peak rate of customs duty, given the currency appreciation over the last year. The reduction of the CENVAT rate from 16% to 14% is a positive move, and will be a competitive stimulus for domestic manufacturing activity. A clutch of services have been added to the ever expanding service tax net, and some clarifications have been proffered on interpretive service tax liability issues. No change to the service tax rate itself has been proposed. CST continues to be scaled back in a calibrated manner, and will slide to 2%, headed towards eventual abolition, co-terminus with the proposed introduction of an integrated Goods and Service Tax legislation in April 2010.

By the Finance Minister's own light hearted reference in his Budget speech today, he has been lucky in several ways for the Government and the country's economy over the years. Not that the present Government has not induced, or not been at the centre of controversy with its annual budgetary proposals (the all-round angst with the FBT legislation a couple of years ago springs to mind); but the Government has generally been able to dig its heels in and build substantive agreement or consensus around its fiscal proposals in Parliament. It is quite likely that the Budget 2008 fiscal proposals will go through some level of debate and iterations as well, but one can reasonably expect that the current proposals

will settle down soon without too many dramatic insertions, modifications, or deletions before being passed by Parliament.

**29 FEBRUARY 2008**

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# At a glance

## Income-tax

- Rates of corporate tax remain unchanged for both domestic and foreign companies.
- Basic exemption limit for individuals increased to Rs 150,000 (Rs 180,000 for resident women and Rs 225,000 for senior citizens).
- Agricultural income to include income from saplings or seedlings grown in a nursery.
- Advancement of any other object of general public utility as referred in the definition of charitable purpose to exclude commercial activity.
- Amounts received by an individual (lump sum or installment) from a transaction of reverse mortgage exempted from income-tax.
- Transfer of capital assets under reverse mortgage scheme not to be taxable.
- STT paid in respect of taxable securities transactions entered into in the course of business to be allowed as a deductible expenditure; rebate for STT discontinued.
- In computing taxable income of an assessee who was not required to compute his total income for any prior year, tax depreciation to be computed on the actual cost of assets less depreciation provided as per books of account.
- Conversion of FCEBs into shares/ debentures exempted from capital gains tax.
- Tax on short-term capital gains (liable to STT) increased from 10% to 15%.
- Deduction for preliminary expenses incurred on extension or setting-up of units will not be restricted to only industrial undertakings or units.

- Expenditure in respect of payment or aggregate of payments made to a person, in a day, in excess of Rs 20,000, otherwise than by way of an account payee cheque drawn on a bank or an account payee bank draft, not allowed as a deduction.
- Sunset clause for tax holiday for undertakings engaged in refining of mineral oil, if it begins refining on or after 1 April 2009.
- 100% deduction over a five year period introduced for eligible undertakings operating and maintaining a hospital anywhere in India (other than specified excluded areas).
- Five year tax holiday introduced for hotels located in specified districts having World Heritage Sites.
- Weighted deduction of 125% introduced for payments made to approved Indian companies engaged in scientific research and development.
- Weighted deduction of 150% will not be available to companies engaging in scientific research and development which are approved by prescribed authorities under the provisions of section 35(1)(iia).
- Deduction now available for investments by individuals and HUF in Post Office Time Deposit Rules, 1981 and Senior Citizens Saving Scheme Rules, 2004. Withdrawals within a five year period taxable in year of withdrawal.
- Increase in deduction for individuals for payment towards medical insurance premium for parents.
- For the purpose of MAT computation, book profits shall be increased by deferred tax and provisions therefore.
- For the purpose of MAT computation, income tax and provision therefor to be added back to book profits also clarified to include tax on distributed profits/ income, interest, surcharge and cess.
- If an assessee will appear in any proceedings or co-operate in any inquiry related to any assessment or reassessment, it will be deemed that appropriate notice has been served on the assessee.
- Assessing officer can *suo motu* extend time limit for completion of special audit.

- Centralised processing of returns to provide for adjustment of income for arithmetical mistakes and incorrect claims.
- Reduction in time limit for serving notice for scrutiny assessment from 12 months to 6 months from the end of the financial year in which the return of income is filed.
- Income involving matters which are subject matter of appeal, reference or revision, not subject to reassessment.
- Higher authorities not required to issue notice of reassessment themselves.
- Certain presumptions as to books of accounts, other documents and assets applicable in case of search, now extended to cases of survey and requisitions by the assessing officer.
- Intimation of summary assessment deemed to be a notice of demand.
- Revival of assessment proceedings where assessment pursuant to search annulled.
- Definition of 'assessee in default' to include person required to withhold taxes.
- Exemption from withholding tax on corporate debt instruments in dematerialised form and listed on recognised stock exchanges.
- Withholding tax on contractor and sub-contractor payments to include payments by all AOPs or BOIs.
- Withholding tax/ collection certificates to be issued for taxes withheld/ collected up to 31 March 2010.
- CBDT given powers to make rules for granting credit for taxes withheld/ collected.
- New provision introduced to protect the right to appeal by the income-tax authorities.
- Definition of specified security for FBT substituted.
- Due date for filing return of FBT for corporates and other specified assesses preponed from 31 October to 30 September.

- Provisions introduced for making adjustments for arithmetical errors and incorrect claims while doing summary assessment of FBT returns.
- Scheme for centralised processing of FBT returns introduced.
- Recognition of FBT recovered from the employee as tax paid by the employee and eligible for credit under any foreign tax law.
- No FBT in respect of expenditure on non-transferable pre-paid electronic meal cards usable at eating joints or outlets.
- No FBT in respect of expenditure on providing crèche facility for employees children, sponsorship of employee sportsperson and organising sports events for employees.
- No FBT in respect of expenditure on maintenance of guest house accommodation.
- Value of fringe benefits on account of expenditure on festival celebrations reduced from 50% to 20% of the total expenditure.
- The due date of filing the return of income for corporates and certain categories of assesses will be preponed from 31 October to 30 September of the relevant assessment year.
- Return of income will be regarded as defective if it is not accompanied by the tax deduction/ collection certificate, with effect from 1 April 2007.
- Direction for initiation of penalty proceedings in the order is deemed as recording of satisfaction for initiation of penalty proceedings. The amendment will take effect retrospectively from 1 April 1988.
- No BCTT shall be charged on taxable banking transactions entered into on or after 1 April 2009.
- Exemption for income of SUUTI extended from 31 January 2008 to 31 March 2009.
- Dividend subject to DDT in case of a domestic company distributing dividend shall be reduced by the dividend received from its subsidiary company, subject to satisfaction of prescribed conditions.

- Scheme for immunity from penalty and prosecution introduced in case of abatement of settlement proceedings.
- Rationalisation of levy of STT on exchange traded options in securities.
- Introduction of commodity transaction tax payable on taxable commodities transaction entered in a recognised association to be charged from a date to be notified. The same will be payable as under:
  - 0.017% of the option premium, by the seller, on sale of option in goods or an option in commodity derivative.
  - 0.017% of the price at which derivative is sold, by the seller, on the sale of any other commodity derivative.
  - 0.125% of the settlement price, by the purchaser, on sale of option in goods or an option in commodity derivative, when option is exercised.
- Notices and other documents used by the income-tax authorities shall deemed to have been authenticated if the name and the office of the designated Income-tax authority is printed, stamped or otherwise written on the notice or other document.
- Time limit for satisfaction of additional condition for grant of recognition to PFs extended up to 31 March 2009.
- Time limit of up to a maximum of 365 days prescribed for ITAT stay orders, even if the delay in disposing of the appeal is not attributable to the assessee.

## Customs duty

- Peak rate of basic customs duty unchanged.
- Effective rate of customs duty reduced from 34.13% to 31.70% (CENVAT credit to manufacturer at 20.93%).

## Excise duty

- Effective rate reduced from 16.48% to 14.42%.

- Element of excise duty payable by EOU, STP and EHTP on clearances to DTA increased from 25% to 50% of BCD.
- BED reduced from 16% to 8% on all drugs and pharmaceuticals.
- Rule 6 of Credit Rules amended to provide option to manufacturer and provider of output service for reversal of credit attributable to input and input services used in the manufacture of exempted goods or providing of exempted service.
- BED on packaged software increased from 8% to 12%.

## Service tax

- Effective service tax rate will remain at 12.36%.
- Service tax extended to seven new services including information technology software services, management of investment under unit linked insurance plan, services provided by recognised stock exchanges and commodity exchanges and services provided in relation to supply of tangible goods.
- The scope of existing taxable services including banking and other financial services, technical testing and certification, tour operator services, widened.
- Transactions between associated enterprises liable to service tax when credited or debited to the books of account.
- Composition rate for works contract increased from 2% to 4%.
- Threshold limit for service tax exemption increased from Rs 0.8 million to Rs 1 million.
- Time limit of 180 days for return of capital goods taken outside the premises of service provider removed.
- Service provider of taxable and exempted services has an option to pay 8% on value of exempted services or reverse CENVAT credit attributable to exempted services.

# Sales tax

- CST rate proposed to be reduced from 3% to 2% (or to a rate to be notified) with effect from 1 April 2008.

# Key performance indicators

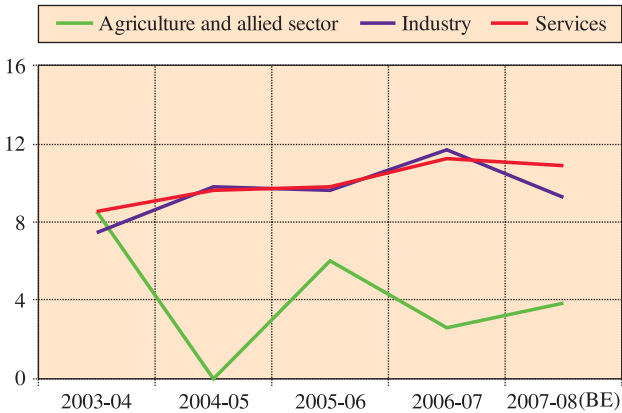
The Economic Survey 2007-08 reports the estimated GDP growth for this year at 8.7% as against 9.6% in 2006-07. The deceleration in the growth rate is primarily on account of decline in growth in the agriculture and industry sectors during the year 2007-08.

**Agriculture and allied sector:** The sector is expected to grow at 2.6% in 2007-08 as against a growth of 3.8% in 2006-07. The season ended with the all-India weighted rainfall at 105% of the long period average. The rainfall was not uniformly distributed over time and region. Besides the weather induced fluctuations, output of this sector has been affected due to reduced capital investment and plateauing of yield levels in major crops.

**Industry:** The growth of the industrial sector has decelerated in the current year. As per the Index of Industrial Production, overall growth in the sector was 9.2% during April to November 2007, as against 11.6% in 2006-07. Growth rates for manufacturing, electricity and mining were 9.8%, 7% and 4.9% respectively. The growth rate has decelerated primarily on account of slowdown in the manufacturing sector.

**Services:** The growth in the sector has continued to be broad based. Trade and hotel services registered an increase from 8.5% in 2006-07 to 12.1% in 2007-08. Community services registered a marginal increase from 6.9% in 2006-07 to 7% in 2007-08. Growth in construction services registered a decline from 12% in 2006-07 to 9.6% in 2007-08. Likewise, financial services registered a decline from 13.9% in 2006-07 to 11.7% in 2007-08.

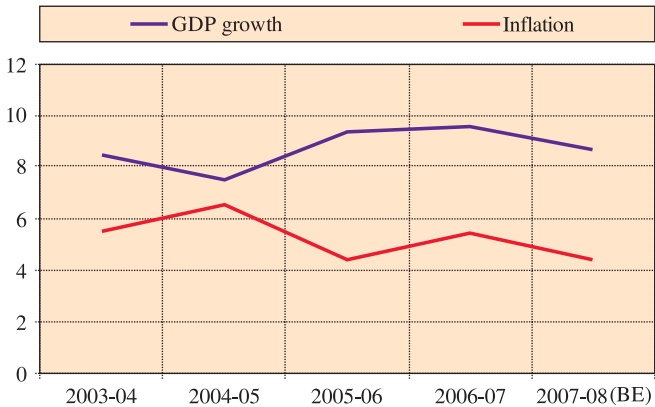
## Sectoral growth rate (%)



Other key economic indicators are summarised below:

- The annual average rate of inflation (in WPI terms) is estimated to decrease from 5.4% in 2006-07 to 4.4% in 2007-08 on account of fiscal, administrative and monetary measures which were taken beginning June 2006, coupled with improved availability of wheat, pulses and edible oil. Year-on-year inflation decreased sharply from 6.3% in 2006-07 to 3.9% in 2007-08. All the major components of the WPI have shown a deceleration in annual inflation in 2007-08.

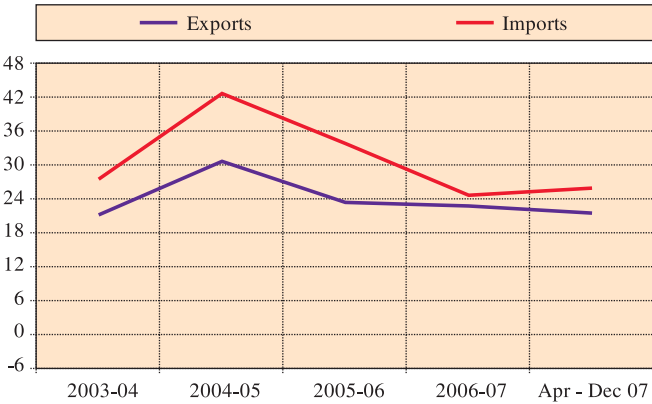
## GDP growth and inflation (%)



- Capital inflows continued their uptrend in recognition of robust macro economic fundamentals like high growth, relative price stability, a healthy financial sector, high returns on investments and an improved investment climate. Foreign exchange reserves rose by USD 91.6 billion from USD 199.2 billion to USD 290.8 billion as on 8 February 2008.

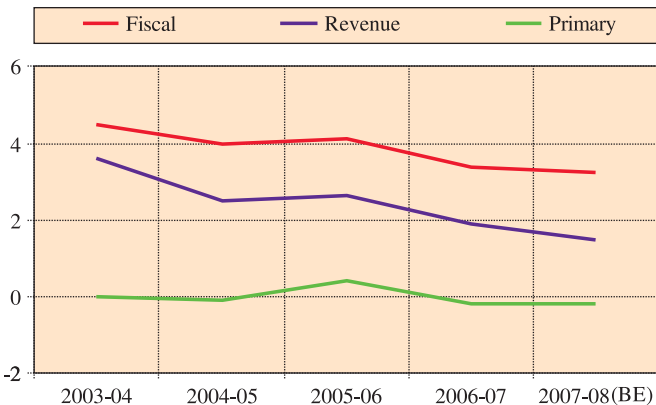
- Merchandise export growth (in USD terms) is estimated to decrease from 22.6% in 2006-07 to 21.6% during April to December 2007. Imports are estimated to increase from 24.5% in 2006-07 to 25.9% during April to December 2007, implying strong industrial demand by the manufacturing sector.

Foreign trade (%)



- Fiscal deficit is estimated at 3.2% of GDP in 2007-08, as against 3.4% of GDP in 2006-07. Primary deficit which stood at -0.2% of GDP in 2006-07 is estimated to remain constant at -0.2% of GDP in 2007-08. Revenue deficit is estimated at 1.5% of GDP in 2007-08 against 1.9% of GDP in 2006-07.

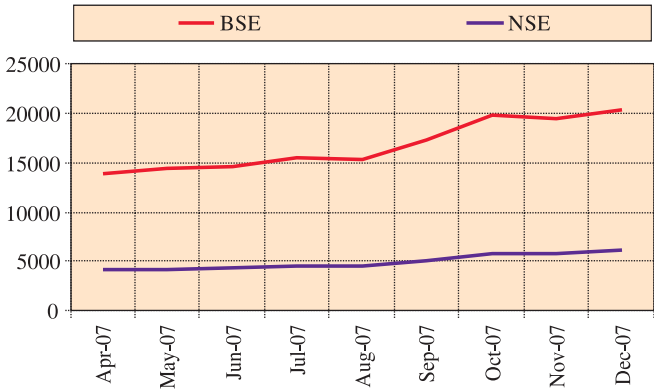
Fiscal, revenue and primary deficit (% of GDP)



- The capital and commodity markets remained buoyant during 2007 with the support of relatively stable macro economic conditions. The stock market saw increased activity in 2007-08 with the BSE index rising from 13,072 points to 18,048 points and the NSE index rising from 3,822 points to 5,277 points,

from March 2007 to 18 February 2008. With the market capitalisation (BSE 500) being 150% of GDP, India compares well with other emerging economies as well as matured markets.

Stock market indicators



While acknowledging that the economy has moved decisively into a higher growth phase, the Economic Survey 2007-08 also recognises that maintaining the growth rate at 9% will be a challenge, and raising it to double digits will be a greater challenge. The challenges of high growth have become more complex because of increased globalisation of the world economy and the growing influence of economic as well as non-economic developments. There is therefore, heightened urgency to augment and upgrade infrastructure, in particular, power, roads and ports. The Economic Survey 2007-08 has recommended the following key initiatives to address the challenges towards achieving high growth:

- Agriculture:** There has been a loss of dynamism in the agriculture and allied sectors in recent years. A gradual degradation of natural resources through overuse and inappropriate use of chemical fertilizers has affected the soil quality resulting in stagnation in the yield levels. The long term policy framework at a broad sectoral level needs to be strengthened and should be focused on improving inter-sectoral and intra-sectoral linkages. In addition, there is a need to build an outcome oriented perspective in the implementation of public programmes in the areas of irrigation, fertilizers, use of high-yielding varieties of seeds, extension of support for facilitating adoption of improved practices and market access. The Government has taken new initiatives in the form of the National Food Security Mission and the Rashtriya Krishi Vikas Yojana to rejuvenate this sector and the sector will benefit immensely from these policy interventions. However, a second

green revolution, particularly in the areas which are rain-fed, may be necessary to improve the income of the persons dependent on the agriculture sector.

- Infrastructure:** The challenges in implementing projects in this sector are immense as each segment in the physical infrastructure sector has its own specificities. The planned average GDP growth of 9% for the Eleventh Five Year Plan period can be achieved only if the infrastructure deficit can be overcome and adequate investment takes place to support higher growth and an improved quality of life for both urban and rural communities. It is important to ensure synergy in the efforts being made to develop different types of infrastructure through effective coordination between different agencies. The critical requirements would have to be determined and well designed efforts by the Government and the private sector partners would be required to implement the policy initiatives already under way, with the requisite amount of detailed technical, managerial, administrative and human skill, and not the least, with the will to implement in a transparent and inclusive manner.
- Finance:** The investment demand is expected to remain strong in the short to medium term and the banking sector is equipped to meet the growing demand for resources. Given this, it is necessary that credit expansion is non-inflationary and the productive sectors receive adequate credit at a reasonable cost. The Government's efforts to streamline the regulatory framework and to bring business transparency may enhance activity in the primary capital market in terms of increase in the number of debt and equity issues as well as larger participation of investors, particularly retail investors.

Against the backdrop of expected expansion of activity in the Indian capital markets, the importance of ensuring healthy and orderly conditions in the market becomes more urgent. Ensuring stable conditions in the market is the responsibility of policy makers, regulators as well as market participants. While the policy initiatives are required to be well calibrated to transmit the right policy signals unambiguously, the regulators need to remain proactive and vigilant to obviate the occurrence of any irregularities in the conduct of business in the market.

A major policy challenge is in the area of corporate debt market. A high-level Committee on Corporate Bonds and Securitisation set up by the Government had gone into the various issues relating to corporate debt market such as

corporate debt issuance, pricing, trading and settlement. The various recommendations of the Committee are under different stages of implementation.

- **Taxes:** The shift in the structure of taxes from relatively regressive indirect taxes to direct taxes continued in 2007-08. The direct tax to GDP ratio has seen an uptrend because of the reforms in income and corporate taxes that simplified the tax system, reduced exemptions and tax rates, thus providing an incentive for better compliance. At the same time, indirect tax to GDP ratio has fallen because of reduction in custom duties and increasing exemptions in excise duties. The Economic Survey 2007-08 further acknowledges that e-commerce will continue to enjoy non imposition of customs duty on electronic transmission due to inherent advantage India has in e-commerce. The Economic Survey 2007-08 further provides that as and when viable methods of levying duties and taxes can be found, it should not preclude imposing custom duty, excise duty, sales tax etc on electronic transmissions.
- **FDI policy reforms:** The Economic Survey 2007-08 offers following FDI policy reform options:
  - Allow a share for foreign equity in all retail trade, with 100% foreign equity in foreign branded, specialised retail chains.
  - Raise foreign equity participation in insurance sector to 49%, with 51% foreign equity in certain special categories for companies focusing on rural and agricultural insurance.
  - Allow 100% FDI in Greenfield Private Rural Agricultural Banks.
- **External trade:** Based on the trends in the first six months of the current financial year and other indicators, trade deficit would continue to widen in the current year.

The outlook for exports in 2008-09 may not be as bright as in the past few years with lower projections in world GDP and world imports and exchange rate developments. Two developments which need to be monitored are the fall in export growth to the United States in general and fall in textiles exports in particular to the United States and even EU. The second development being the fall in exports of business services, though import growth of these services has also fallen and this calls for some fundamental policy changes besides

relief measures already given. For services trade, the two major areas where reforms can help in sustaining export growth are related to domestic regulations and reforms and market access for services.

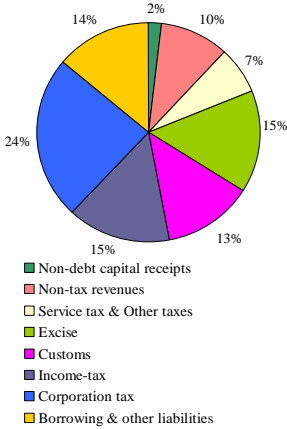
Convergence of domestic and global interest rates is a *sine qua non* for fuller capital account convertibility, while similarity of tax rates and structures to international or regional levels will be very helpful.

- **Inflation:** Overall inflation is likely to remain moderate in the coming months, as the policy measures taken during the course of the year work their way through the system. The behaviour of agricultural prices, including essential consumption items, will be critical, given falling poverty and rapidly rising per capita income. Management of domestic supply management is critical to stabilising inflation expectations, moderating pressures for upward revision of wages and prices and containing pressures for cost push inflation through monetary and fiscal accommodation.
- **Social sector programmes:** There has been an improvement in many important social indicators like life expectancy, infant mortality rate and gross enrolment ratios at primary level of education along with higher economic growth and poverty reduction. However, disparities continue at the state and regional level. Better governance and improved service delivery are essential to ensure that leakages are plugged and the funds under the welfare schemes reach the intended beneficiaries to the maximum extent. Local Governments, Panchayati Raj institutions along with social and non-government organizations can play an important role in this area.

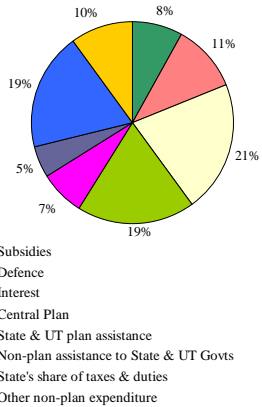
Note: All figures are as per the Economic Survey 2007-08 BE: Budget Estimates
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# Budget Financials

Where the Rupee comes from



Where the Rupee goes to



- The annual financial statements of the Government for 2007-08 are set to reflect a fiscal deficit of 3.1% of GDP, marginally lower than the budget estimate of 3.3%. The target fiscal deficit for 2008-09 is 2.5%. Revenue deficit for 2008-09 is estimated at 1% as against the revised estimate of 1.4% for 2007-08. As a result of the buoyancy in the Indian economy, the Central Government expects to meet the targets relating to the fiscal deficit under the FRBMA. However, targets relating to revenue deficit would require to be rescheduled primarily on account of a shift in Plan priorities in favour of revenue expenditure intensive programmes and schemes and a systemic rigidity in containing non-plan expenditure in the short term.
- Market borrowings are expected to finance approximately 95% of the Government's fiscal deficit in 2007-08. While the interest outgo (including prepayment premium) in absolute terms is set to increase, the interest outgo (including prepayment premium) as a percentage of the revenue receipts is set to decline from a high of 53.34% in 2001-02 to 32.75% in 2007-08 and is estimated to be 31.65% in 2008-09. The declining trend is on account of prudent fiscal policy estimated to result in lower recourse to borrowings as well as an estimated increase in revenue receipts. Expenditure on major subsidies namely food, fertilizers and petroleum, is estimated to increase.

- In the budget for 2008-09, the Government has estimated:
  - gross tax revenues at Rs 6,877 billion, representing an increase of approximately 17.48% over the revised estimates of Rs 5,854 billion for 2007-08.
  - plan expenditure at Rs 2,434 billion, representing an increase of approximately 17.28% over the revised estimates of Rs 2,075 billion for 2007-08. As a proportion of the total expenditure, plan expenditure is estimated to increase to 32.41% over the revised estimate for 2007-08 of 29.25%. Non-plan expenditure is estimated to increase to Rs 5,075 billion representing an increase of 1.13% over the revised estimates for 2007-08.

# Budget Proposals

This section summarises significant proposals on direct and indirect taxes and policy initiatives announced in the Union Budget 2008. Most direct tax proposals in the Finance Bill are effective from the financial year commencing on 1 April 2008, unless otherwise specified. Most indirect tax proposals are effective immediately. Further, policy initiatives are expected to be implemented by the Government through legislative announcements over the ensuing months.

The Finance Bill is discussed in the Parliament before enactment, and is subject to amendments resulting from these discussions.

## Direct tax

### Income-tax

#### Rates of tax

##### Personal tax rates

Existing		Proposed	
Income (Rs)	Rate (%)	Income (Rs)	Rate (%)
0-110,000	Nil	0-150,000 <sup>#</sup>	Nil
110,001-150,000	10	150,001-300,000	10
150,001-250,000	20	300,001-500,000	20
250,001-1,000,000	30	500,001-1,000,000	30
1,000,001 and above	30*	1,000,001 and above	30*

@ Education cess of 3% is leviable on the amount of income-tax and surcharge.

\*Surcharge of 10% of the total tax liability is applicable where the total income exceeds Rs 1,000,000.

# The exemption limit is Rs 180,000 (earlier Rs 145,000) in case of resident women below the age of 65 years and Rs 225,000 (earlier Rs 195,000) in case of resident individuals of the age of 65 years or more.

## Corporate tax rates

Rates of corporate tax remain unchanged for both domestic and foreign companies.

Description	Rate * (%)
<b>A) Domestic company</b>	
Regular tax	33.99 <sup>@</sup>
MAT	11.33 (of book profits)
DDT	16.995
<b>B) Foreign company</b>	
Regular tax	42.23 <sup>#</sup>

\* Inclusive of applicable surcharge and education cess

<sup>@</sup> 30.90% where the total income is equal to or less than Rs 10 million

<sup>#</sup> 41.20% where the total income is equal to or less than Rs 10 million

## Definitions

Amendment to the definition of 'agricultural income'

- A clarificatory explanation has been inserted in the definition of 'agricultural income' to include income derived from saplings or seedlings grown in a nursery.

## Amendment to the definition of ‘charitable purpose’

- The definition of ‘charitable purpose’ presently includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility. The term ‘advancement of any other object of general public utility’ has now been amended to exclude the following activities carried out for a consideration:
  - activities in the nature of trade, commerce or business; and
  - activities of rendering services in relation to trade, commerce or business.

The above exclusion will be applicable irrespective of the nature of use or application, or retention, of the income from the said activity.

## Exempt income

### Exemption of income of the Coir Board

- Presently, an exemption is available under section 10(29A) in respect of income of certain commodity boards and export development authorities. The said exemption has now been extended to include the income of the Coir Board set-up under the Coir Industry Act, 1953.

### Exemption of amount received from a reverse mortgage

- Any amount received by an individual by way of a loan (lump sum or installment) from a transaction of reverse mortgage will be exempt from tax.

## Business income

### Deduction for STT paid

- STT paid in respect of taxable securities transactions will now be allowed as a deductible expenditure provided that income from such taxable securities transactions is included under the head ‘profits and gains from business and profession’.

Consequently, the rebate currently available for STT paid will be discontinued.

## Amendment to definition of Written Down Value

- In computing the taxable income of an assessee who was not required to compute his total income for any prior year, the written down value of the assets would be required to be computed as follows:
  - The actual cost of the asset shall be adjusted by the amount attributable to revaluation, if any, in the books of account;
  - The total amount of depreciation provided in the books of account shall be deemed to be the tax depreciation actually allowed; and
  - The tax depreciation actually allowed above shall be adjusted by the amount of depreciation attributable to the revaluation.

The above amendment will take effect retrospectively from 1 April 2002.

## Capital Gains

### Conversion of Foreign Currency Exchangeable Bonds

- Conversion of FCEBs into shares or debentures of any company will not be taxable. Cost of acquisition of FCEBs will be deemed to be the cost of acquisition of the shares/ debentures issued pursuant to the conversion of FCEBs.

The above amendment will take effect retrospectively from 1 April 2007.

### Change in rate of short-term capital gains tax

- Tax on short-term capital gains earned pursuant to transfer of equity shares of a company or units of an equity oriented fund, where such transaction is chargeable to STT, will now be increased from 10% to 15%.

### Reverse mortgage not taxable

- The Finance Minister had announced in the Union Budget of 2007 that the National Housing Bank would introduce a reverse mortgage scheme for senior citizens. Pursuant to the announcement, some of the banks have also formulated schemes of reverse mortgage.

- The scheme of the National Housing Bank will typically contain the following:
  - It will be applicable to senior citizens over 62 years of age;
  - The lender will make periodic payments (including lump sum payments) to the borrower and the loan will not be required to be serviced;
  - The loan will be repaid on the death of the borrower through the sale of property; and
  - Maximum period of the loan will be 15 years.
- The transfer of capital assets under a reverse mortgage scheme will not be taxable.

The above amendment will take effect retrospectively from 1 April 2007.

## Deductions from business income

### Amortisation of preliminary expenses

- Expenditure incurred on the preparation of a feasibility report, project report, market survey, legal charges, etc after commencement of business is presently allowed if the expenditure is incurred in connection with the extension of the industrial undertaking or for setting-up of a new industrial unit. This deduction will be allowed for setting-up or extension of all units and will not be restricted to industrial undertakings or units.

### Sunset clause for tax holiday for undertakings engaged in refining of mineral oil

- Presently, a seven year tax holiday is allowed in respect of profits derived from commercial production or refining of mineral oil. Now, the tax holiday will not be available if the undertaking begins refining on or after 1 April 2009.

### Definition for hotels/ convention centres

- Presently, a tax holiday for five consecutive years is allowed for two-star, three-star or four-star hotels or convention centres of prescribed size, located in specified areas. Now a tax holiday for five consecutive years will also be available for profits and

gains of hotels located in specified districts having World Heritage Sites, if such hotel is constructed and starts functioning at any time between 1 April 2008 and 31 March 2013.

### Deduction for operating and maintaining a hospital in certain areas in India

- Presently, an eligible undertaking which operates and maintains a hospital in a rural area will be eligible for a deduction of 100% of its profits for a period of five consecutive years, subject to fulfilment of certain conditions. One of the key conditions for availing the deduction is that such hospital is constructed on or before 31 March 2008.
- Now an eligible undertaking which operates and maintains a hospital anywhere in India (other than in specified excluded areas) will be eligible for a deduction of 100% of its profits for a period of five consecutive years, subject to fulfillment of following key conditions:
  - The hospital is constructed and starts functioning at any time between 1 April 2008 to 31 March 2013;
  - The hospital has at least 100 beds; and
  - The construction of hospital is in accordance with regulations and bye-laws of the local authority.

### Weighted deduction for amount paid to a company for scientific research

- Presently, a weighted deduction of 125% of the sum paid to an approved scientific research association, approved university, college or other institution is available to the payer.

Now, a weighted deduction of 125% of the sum paid to an Indian company will be allowed has a deduction under section 35(1)(iia) provided such company has its main object scientific research and development and satisfies prescribed conditions.

- Presently section 35(2AB) provides for weighted deduction of 150% of expenditure on scientific research or in-house research and development facility for a company engaged in the business of bio-technology or production or manufacture of drugs,

pharmaceuticals, electronic equipment, computers, telecommunication equipment, chemicals, etc.

Now, the above deduction will not be available for companies engaged in scientific research and development and approved by prescribed authorities under section 35(1)(iia).

#### Expenses not deductible in certain circumstances

- Expenditure incurred in respect of payments or aggregate of payments made to a person, in a day, in excess of Rs 20,000, otherwise than by way of an account payee cheque drawn on a bank or an account payee bank draft, will now not be allowed as a deduction.

### Other deductions under Chapter VI A

#### Additional eligible investment option

- Following investments by individuals and HUFs will be now eligible for deduction
  - Five year time deposit in an account under Post Office Time Deposit Rules, 1981.
  - Deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.
- Premature withdrawal of deposits taxable as follows:
  - Withdrawal of any of the deposits including interest accrued (not taxed earlier) on such deposits before the expiry of five years from the date of its deposit will be deemed as income of the assessee in the year of withdrawal.
  - Amount taxable will not include any amount received by the nominee or legal heir of the assessee other than interest not included in the total income of the assessee for any previous year.

#### Increase in deduction for medical insurance premium paid for parents

- Presently, a deduction of Rs 15,000 (Rs 20,000 for senior citizens) is available to an individual for payment of medical insurance premium for self, family and dependent parents.

- Now, an additional deduction of Rs 15,000 (Rs 20,000 for senior citizens) is available to an individual for payment of medical insurance premium for parents.

## MAT

### Clarification for MAT computation

- Presently, there is ambiguity on whether items such as deferred tax need to be added back to the book profits for the purpose of computing MAT. The scope of MAT is now widened to provide that book profits shall be increased by the amount of deferred tax and provisions therefor.

The above amendment will take effect retrospectively from 1 April 2000.

- Presently, companies are required to add back income-tax and the provision therefor, to the book profit for the purpose of computing MAT. It is now clarified that income-tax shall include the following items:
  - tax on distributed profits or distributed income;
  - any interest charged under the Income-tax Act;
  - surcharge;
  - education cess on income-tax; and
  - secondary and higher education cess on income-tax.

The above amendment will take effect retrospectively from 1 April 2000.

## Assessment procedures

### Deeming provisions for service of notice and time limit

- Presently, a notice is required to be served on an assessee on time and in a prescribed manner. Now, an assessee will be deemed to have been served a notice in accordance with the Income-tax Act where an assessee has appeared in any proceedings or cooperated in any inquiry related to any assessment or reassessment. Further, such assessee will be precluded from taking any objections in any proceeding of

inquiry that the notice was not served, not served in time or served in an improper manner.

### Presumption as to books of account, other documents and specified assets

- Presently, the presumption that the books of accounts, other documents and specified assets found in the possession or control of the person belong to such person and such books of account and documents are correct, applies in cases of a search. Now, such presumption has been extended to survey operations also.

This amendment will take effect retrospectively from 1 June 2002.

- The above presumption will also extend to books of account, other documents and assets delivered to the requisitioning officer.

This amendment will take effect retrospectively from 1 October 1975.

### Assessing officer can suo motu extend time limit for completion of special audit

- Presently, the assessing officer can extend the time limit for completion of a special audit only if an application is made in this behalf by the assessee and where there are good and sufficient reasons for such extension. Now, the assessing officer has been granted power to extend such time limit on his own.

The above amendment will take effect from 1 April 2007.

### Adjustment of income for arithmetical mistakes and incorrect claims through centralised processing of returns

- The present scheme of summary assessment is limited to confirming the correctness of taxes paid on the income returned and does not contain any provision allowing an adjustment to the returned income for correcting arithmetical mistakes or incorrect claims.
- Now, a new mechanism for processing of returns is proposed, the key features of which are as follows:

- The total income or loss shall be computed after making adjustments for any arithmetical errors or any incorrect claims which are apparent from the information in the return.
- The sum payable or any refund due shall be determined after adjustment of the tax and interest payable on the total income so computed by any taxes paid, taxes deducted and collected at source, eligible foreign tax credits and allowable rebates.
- The CBDT may formulate a scheme for centralised processing of returns with a view to expeditiously determining the tax payable or refund due.

The above amendment will take effect from 1 April 2007.

#### Reduction in time limit for serving notice for scrutiny assessment

- Presently, the time limit for serving notice for scrutiny assessment is 12 months from the end of the financial year in which the return is furnished. Now, the time limit is reduced to 6 months from the end of the financial year in which the return is furnished.

The above amendment will take effect from 1 April 2007.

#### Income involving matters which are subject matter of appeal, reference or revision not subject to reassessment

- The assessing officer has the power to reassess any income that has escaped assessment. There have been conflicting judicial precedents on the matter as to whether the assessing officer's power to reassess income that has escaped assessment extends to income which is the subject matter of any appeal, reference or revision proceedings.

Now, it is provided that the assessing officer will have the power to assess or reassess income that has escaped assessment in respect of all matters, other than which are the subject matter of appeal, reference or revision.

A similar amendment has also been proposed in the Wealth Tax Act.

The above amendment will take effect from 1 April 2007.

## Sanction for issue of notice of reassessment

- Higher authorities (namely the Joint Commissioner, Commissioner and Chief Commissioner) are required to satisfy themselves, based on the reasons recorded by the assessing officer, that it is a fit case for issue of notice of reassessment. However, certain judicial precedents have held that such notices should be issued by the higher authorities themselves.

Now, it is clarified that the higher authorities are only required to be satisfied of the reasons recorded by the assessing officer, and there is no further requirement to issue the notice themselves.

A similar amendment has also been proposed in the Wealth Tax Act.

The above amendment will take effect retrospectively from 1 October 1998.

## Intimation to be a deemed notice of demand

- Presently, where any sum is payable as a consequence of any assessment order passed, the assessing officer is required to serve upon the assessee a notice of demand. Now, where any sum is payable as per intimation of summary assessment, it will be deemed to be a notice of demand.

The above amendment will take effect from 1 April 2007.

## Revival of assessment proceedings where assessment pursuant to search annulled

- If assessment/ reassessment proceedings pursuant to search are annulled in appeal/ legal proceedings, the abated assessment/ reassessment in respect of that year will stand revived. In case the order of annulment is set aside, such revival will cease to have effect.

This amendment will take effect retrospectively from 1 June 2003.

## Withholding tax

Assessee in default to include person required to withhold taxes

- A clarification has been introduced to provide that an 'assessee in default' includes any person required to withhold taxes irrespective of whether such taxes have been withheld.

This amendment will be applicable with retrospective effect from 1 June 2002.

Exemption from withholding tax on corporate debt instruments

- Presently, interest payable on securities is subject to withholding taxes. Now, interest payable to residents on any security issued by a company, where such security is in dematerialised form and listed on a recognised stock exchange in India, will be exempt from withholding tax.

This amendment will take effect from 1 June 2008.

Expansion of withholding tax net to include payments by AOPs or BOIs

- Presently, contractor or sub-contractor payments by specific entities, including some AOPs or BOIs, and not all AOPs or BOIs in general, are subject to tax withholding. Now, all AOPs or BOIs, whether incorporated or not, will be liable to withhold taxes on payments made to contractors or sub-contractors.

This amendment will take effect from 1 June 2008.

Furnishing information of payment to non-residents

- Presently, details of payments made to non-residents and taxes withheld, if any, thereon are required to be reported to the RBI which, in turn, would forward the details to the Assessing Officer. Now, the person making the payment and responsible for withholding taxes will be required to furnish the details in a form and manner as prescribed by the Board.

This amendment will take effect from 1 April 2007.

## Requirement to issue tax withholding/ collection certificates

- Presently, there is no requirement to issue tax withholding/ collection certificates for taxes withheld/ collected on or after 1 April 2008. Now, the date has been extended to 1 April 2010. Hence, tax withholding/ collection certificates will have to be issued for taxes withheld/ collected up to 31 March 2010.

This amendment will take effect from 1 April 2007.

## Credit for taxes withheld/ collected subject to CBDT rules

- Presently, credit for taxes withheld/ collected at source is subject to furnishing tax withholding/ collection certificates. Now, the CBDT has been given powers to make rules for granting credit for such taxes withheld/ collected.

This amendment will take effect from 1 April 2007.

## Appeals

### New provision introduced to protect the right to appeal by the income-tax authorities

- As per the new provisions, CBDT to regulate filing of an appeal/ application for reference by the income-tax authorities.

This provision will be applicable retrospectively with effect from 1 April 1998.

## Stay of demand

### Time limit for grant of stay by ITAT

- Now, the ITAT will not grant a stay beyond an aggregate period of 365 days, even if the delay in disposing of the appeal is not attributable to the assessee.

The above amendment will take effect from 1 October 2008.

## Fringe benefit tax

### Enabling provisions for claim of FBT against foreign taxes

- FBT will now be recognized as tax paid by the employee in connection with a claim of tax credit in a foreign country by the employees. Key aspects of this amendment are:
  - Presently, there is no express provision for the FBT paid by the employer as a result of allotment or transfer of specified securities or sweat equity shares and recovered from the employee under the Income-tax Act, to be recognised as tax payment by the employee.
  - Now, the FBT payable has been recognised as tax payment under the Income-tax Act, which would be available as credit for set-off against the tax liability of the employee.
  - However, this benefit is not available for credit purposes and is likely to benefit employees claiming credit under foreign tax laws.
  - No refund of this FBT is available to the employee under the Income-tax Act.
  - The above amendment will take effect retrospectively from 1 April 2007.

### Relief from FBT

- Expenditure on or payment through non-transferable pre-paid electronic meal cards usable only at eating joints, will now be excluded from ‘hospitality’ and will not be subject to FBT.
- The following expenses will now be excluded from ‘employees welfare’ and will not be subject to FBT:
  - Expenditure on providing crèche facility for employees children;
  - Expenditure on sponsorship of employee sportsperson; and
  - Expenditure on organising sports events for employees.
- Presently, expenditure on maintenance of guest house accommodation, excluding accommodation used for training purposes, is subject to FBT. Now, such expenditure will not be subject to FBT.
- The value of fringe benefits on account of expenditure on festival celebrations has reduced from 50% to 20%.

## Others

- Presently, the definition of specified security includes employees stock options. Now, this inclusion is substituted with securities offered under an employee stock option plan or scheme.
- Due date for filing FBT returns for corporates and other specified assessees preponed from 31 October to 30 September.
- The existing summary assessment widened to make the following adjustments to the value of fringe benefits:
  - arithmetical errors; and
  - incorrect claims apparent from information in the FBT return, as defined.
- Scheme for centralised processing of FBT returns introduced.
- The above amendments will take effect retrospectively from 1 April 2007.

## Penalty

### Deemed satisfaction for initiation of penalty proceedings

- It is now clarified that where any amount is added or disallowed in computing the total income or loss of an assessee and the order contains a direction for initiation of penalty proceedings, the same shall be deemed to constitute satisfaction for the assessing officer to initiate penalty proceedings.

The above amendment will take effect retrospectively from 1 April 1988.

A similar deeming provision has also been introduced in the Wealth Tax Act.

## Others

### Levy of BCTT withdrawn

- Currently, BCTT is charged in respect of every taxable banking transaction entered into on or after 1 June 2005 at the rate of 0.1% on the value of every such banking transaction.

Now no BCTT will be charged on taxable banking transactions entered into on or after 1 April 2009.

### Exemption to SUUTI extended to 31 March 2009

- The exemption to SUUTI from income-tax or any other tax on any income, profits or gains derived or any amount received in relation to the specified undertaking, which was available until 31 January 2008, has now been extended up to 31 March 2009.

### Amendment to provision relating to DDT

- Presently, any amount declared, distributed or paid by a domestic company by way of dividend is subject to DDT. Now, the dividends subject to DDT will be reduced by the dividend received by the domestic company, provided the following conditions are satisfied:
  - the dividend is received from its subsidiary;
  - the subsidiary has paid tax on the dividend; and
  - the domestic company is not a subsidiary of any other company.
- A company shall be said to be a subsidiary of another company if more than half of the nominal value of the equity share capital of such company is held by the other company.

### Immunity from penalty and prosecution in case of abatement of settlement proceedings

- A new scheme for settlement of cases was introduced by the Finance Act 2007. As per the scheme, if an order for settlement is not passed within the prescribed period, the proceedings before the Settlement Commission will abate and the income-tax authority will resume and complete the proceedings.
- In such cases of abatement, the following scheme has now been introduced for immunity from penalty:
  - The tax payer can make an application to the Commissioner at any time for immunity if the penalty was levied before or during the pendency of settlement proceedings. However, if no such penalty was levied till the time of abatement of settlement proceedings, then the assessee may apply for

immunity before imposition of penalty by the income-tax authority.

- Immunity can be granted by the Commissioner on satisfaction of the fact that the assessee has cooperated in the proceedings after abatement and has made a full and true disclosure of the income and the manner in which such income is derived.
- Immunity granted can be withdrawn, if the conditions for immunity are not complied with or the Commissioner is satisfied that after abatement, the assessee concealed any particulars from the income-tax authority or gave false evidence.

Similar provisions have been introduced for immunity from prosecution.

The above amendment will take effect from 1 April 2007.

A similar amendment has also been proposed in the Wealth tax Act.

- In case of abatement, a minimum period of one year will be allowed to the income-tax authority for completion of assessment. This amendment will take effect from 1 June 2007.

#### Rationalisation of levy of STT on exchange traded options in securities

- Currently, STT is levied on the sale of all exchange traded options in securities at the rate of 0.017% on the aggregate value of strike price and option premium. Now, the levy of STT on exchange traded options in securities will be rationalised as follows:
  - Levy of STT on the sale of an option in securities at the rate of 0.017% on the option premium, payable by the seller.
  - Levy of STT on sale of an option in securities, where option is exercised, at the rate of 0.125% on the settlement price, payable by the purchaser.

The above amendment will take effect from 1 June 2008.

## Introduction of commodities transaction tax

- A new tax, commodities transaction tax, will be introduced. The salient features of this new regime are as follows:
  - The commodities transaction tax shall be charged from a date that is to be notified.
  - The tax will be charged on taxable commodities transactions entered on a recognized association.
  - The value of commodities transaction and tax rate are:

Taxable commodities transactions	Rate	Value	Payable by
Sale of an option in goods or an option in commodity derivatives	0.017%	Option premium	Seller
Sale of an option in goods or an option in commodity derivatives, where the option is exercised	0.125%	Settlement price of option	Purchaser
Sale of any other commodity derivatives	0.017%	Price at which derivative sold	Seller

- The responsibility for the collection of the commodities transaction tax and payment to the credit of the Government treasury will be with the recognised association where the transaction is entered into.
- The recognised association will be required to furnish a return in a prescribed form at the end of the financial year, in respect of all transactions entered on the recognised association.

- Detailed provisions in respect of interest/ penalty on defaults, assessments and matters relating thereto have also been provided.
- Commodities transaction tax will be allowable as a deductible expenditure in computing income under the head 'profits and gains of business and profession'.

#### Due date for filing return of income preponed

- The due date for filing the return of income in respect of the following categories of assesses will be preponed from 31 October to 30 September:
  - A company;
  - A person (other than a company) whose accounts are required to be audited under the Income-tax Act or under any other law for the time being in force; and
  - A working partner of a firm whose accounts are required to be audited under the Income-tax Act or under any other law for the time being in force.

The above amendment is effective from 1 April 2007.

#### Defective return of income

- Presently, due to the introduction of e-filing of the return of income, the requirement of filing withholding tax certificates alongwith the return of income had been dispensed with from 1 April 2007. Now, the tax withholding certificate has to be filed, failing which the return of income will be regarded as defective.

#### Authentication of notices and other documentation

- Now, notices issued to tax payer will be deemed to have been authenticated if the name and the office of the designated income-tax authority is printed, stamped or otherwise written on the notice or other document issued to the tax payer.

#### Recognition of Provident Funds

- Time limit for satisfying the additional conditions for recognition of PFs has been extended to 31 March 2009.

# Indirect tax

## Customs duty

### Policy changes

- Peak rate of basic customs duty remains unchanged.
- Effective rate of customs duty has been reduced from 34.13% to 31.70% (CENVAT credit to manufacturer at 20.93%).
- Amount recovered as customs duty by any person in excess of the customs duty paid has to be deposited to the Central Government alongwith interest.
- Refund of pre-deposit arising on order of appellate authority has to be paid with interest, if not paid within 3 months after the date of communication of appellate order.

### Other changes

- Export duty rate on chromium ores and concentrates has been increased from Rs 2,000 per metric ton to Rs 3,000 per metric ton.
- Specified power projects and high voltage power transmission projects to be liable to 4% SACD.
- NCCD will be imposed at 1% on mobile phones.
- Tariff rate for electrical energy has been introduced at Rs 2,000 per 1,000 KWH. However, presently the same is exempted by way of notification.

### Rate movement

- Changes in the basic rates of customs duty on some key items are set out below:

Items	Rate movement (%)		
	Basic Duty		Movement
	From	To	
Aluminum scrap	5	Nil	↓
Bactofuges	7.5	Nil	↓
Cigars, cheroots and cigarillos	30	60	↑
Crude or unrefined sulphur	5	2	↓
Feed additives/ pre-mixes	30	20	↓
Helicopter simulators	10	Nil	↓
Life saving drugs and bulk drugs for manufacturing	10	5	↓
Melting scrap of iron or steel	5	Nil	↓
Project imports	7.5	5	↓
Phosphoric acid	7.5	5	↓
Polished cubic zirconia	10	5	↓
Rough cubic zirconia	5	Nil	↓
Specified parts of set top boxes	7.5	Nil	↓
Specified convergence products	10	5	↓
Specified machinery for manufacture of sports goods	7.5	5	↓
Specified raw materials for tyre industry	10	5	↓
Tuna bait	30	Nil	↓
Unworked or simply prepared corals	10	5	↓
Vitamin mix for poultry feed	30	20	↓

# Excise duty

## Policy changes

- Effective rate has been reduced from 16.48% to 14.42%.
- Element of excise duty payable by EOU, STP and EHTP on clearances to DTA has been increased from 25% to 50% of BCD.
- *Ad-valorem* duty structure has been replaced with specific duty structure for unbranded petrol and diesel.
- Excise duty has been reduced from 16% to 8% on all drugs and pharmaceuticals.
- Explanation has been inserted to provide that goods shall include any article or substance capable of being bought and sold and shall be deemed to be marketable.
- CEA has been amended to enable levy of duty on the basis of capacity of production in respect of notified goods.
- CEA has been amended to provide for refund of interest paid on duties.
- CEA has been amended to provide for recovery of any amount collected as excise duty from any person with respect to exempted goods along with interest in case where such an amount is not paid to the exchequer.
- Provision has been introduced to provide for payment of interest on pre-deposits, if appellant succeeds, and same is not refunded within three months.
- CETA has been amended to provide that process of lamination or lacquering shall also amount to manufacture in addition to the process of metallisation.
- Excise duty has been revised on bulk cement from Rs 400 per tonne to 14% or Rs 400 per tonne whichever is higher. However, there will be no change in respect of cement manufactured and cleared from mini cement plant.
- NCCD has been withdrawn on polyester filament yarn.

- NCCD has been levied on cellular phones at 1% *ad-valorem*. Further, Credit Rules have been amended to provide that for payment of such NCCD, credit of any duty of excise other than NCCD cannot be utilised.
- Credit Rules have been amended to provide the following options to the manufacturer (opting not to maintain separate accounts):
  - Reverse credit attributable to input and input services (in the manner prescribed) used in the manufacture of exempted goods; or
  - Pay 10% of the value of the exempted goods.
- The Central Excise (Determination of Retail Sale Price of Excisable Goods) Rules, 2008 have been notified to provide the manner of determination of retail sale price where the same is not declared on the packages or tampered, altered or obliterated.
- A new rule has been introduced under Credit Rules to provide for general penalty of Rs 5,000 for contravention of any provision of Credit Rules for which no specific penal provisions exists.
- Rate of duty on packaged software has been increased from 8% to 12%.

## Rate movement

- Changes in the basic duty rates on some key items are set out below:

Items	Rate movement (%)		
	Basic Duty		Movement
	From	To	
Drug formulations	16	8	↓
Small cars	16	12	↓
Hybrid cars	24	14	↓
Two wheelers and passenger	16	12	↓

Items	Rate movement (%)		
	Basic Duty		Movement
	From	To	
three wheelers (up to 7 persons)			
Cornflakes and breakfast cereals	16	8	↓
Tea and coffee pre-mixes	16	Nil	↓
Wireless data modem cards	16	Nil	↓
MP4 player	16	8	↓
Water filtration and purification devices	16	8	↓
Cigarettes (non filtered)			
• Length not exceeding 60mm	Rs 168 per thousand	Rs 819 per thousand	↑
• Length exceeding 60mm	Rs 546 per thousand	Rs 1323 per thousand	↑
Inks for marker pens and highlighters	16	8	↓
Clinker	Rs 350 per MT	Rs 450 per MT	↑
Printers – line, dot matrix, laser, daisy wheel and ink jet	16	Nil	↓
Packaged software	8	12	↑

## Central sales tax

- CST rate proposed to be reduced from 3% to 2% (or to a rate to be notified) with effect from 1 April 2008
- Considerable progress made in preparing roadmap for introduction of National Goods and Service Tax to be implemented with effect from 1 April 2010

# Service tax

Effective service tax rate to remain unchanged

- The effective service tax rate will remain at 12.36%.

The key changes mentioned below will take effect from a date to be notified after the enactment of the Finance Bill

- Service tax will be levied on the following seven additional services:
  - Information technology software services (this covers development and enhancement of software, advice on software related matters, acquiring right to use software for commercial exploitation and software supplied electronically);
  - Management of investment under unit linked life insurance plan;
  - Services provided by a recognised stock exchange in relation to securities;
  - Services provided by a recognised association or commodity exchange in relation to goods or forward contracts;
  - Services provided by a processing and clearing house in relation to processing, clearing and settlement of transactions in securities, goods or forward contracts;
  - Services provided in relation to supply of tangible goods, without transferring right of possession and effective control of said tangible goods (other than where VAT is payable or paid); and
  - Services provided in relation to internet telecommunications including internet backbone and access services.
- The scope of key existing taxable services will be amended as follows:
  - Exclusion for ‘computer software engineering services’ and ‘information technology services’ under consulting

engineer services and business auxiliary service, will be withdrawn.

- Banking and other financial services will include purchase and sale of foreign currency and money changing (proposed that where consideration not specified, service tax will be levied at the rate of 0.25% of gross amount of currency exchanged).
- Technical testing and certification services will include testing, analysis and certification of information technology software.
- Business auxiliary services clarified to include promotion or marketing of lottery.
- Cargo handling services will include services of packing together with transportation, with or without other services such as loading, unloading or unpacking.
- Renting of immovable property clarified to include use of space, irrespective of transfer of possession or control.
- Tour operator services will include any tours in contract carriage excluding journey organised by an educational body.
- ‘Properties’ clarified to include information technology software under management, maintenance or repair services.
- In 39 service categories the reference to ‘client’ or ‘customer’ will be replaced by ‘any person’.

The following changes will be effective from 1 March 2008

- The following key exemptions will be introduced:
  - Services provided by a person located outside India to a customer located outside India in relation to booking of accommodation in a hotel located in India.
  - Recipient of goods transport agency services will be eligible for 75% abatement without any conditions. Goods transport agencies will not be eligible to CENVAT credit.

- Composition rate for works contract service will be increased from 2% to 4%.
- Maintenance services, testing and certification services provided through internet will qualify as export if the goods or property are located outside India, even if the service is performed in India. Reverse criteria to qualify as import of service.
- Self adjustment of service tax paid in advance will be allowed to all assessees. Limit for self adjustment of excess service tax will be increased from Rs 0.05 million to Rs 0.1 million.
- Period for filing of revised return will be increased from 60 days to 90 days from date of submission of original return.

The following changes will take effect from 1 April 2008

- Threshold limit for service tax exemption will be increased from Rs 0.8 million to Rs 1 million.
- Time limit of 180 days for return of capital goods taken outside the premises of service provider now removed.
- A service provider of taxable and exempted output services will have an option of payment of 8% on value of exempt services or reverse CENVAT credit on inputs and input services attributable to exempted services in a prescribed manner.
- Output service provider will be allowed to take credit of inputs and capital goods on the basis of bill issued by its other offices which receive such purchase invoices.
- Credit of input services used for clearance of final products will now be allowed only 'up to' the place of removal.

The key changes mentioned below will take effect on enactment of the Finance Bill

- Transactions between 'associated enterprises' (as defined under Income-tax Act) will be liable to service tax when credited or debited to an account, though amount is not actually received or paid.
- Power to make best judgement assessment by central excise officer has been reintroduced.

- Penalty for delay in payment of service tax will not apply where penalty for suppressing value is payable.
- Failure to register and furnish records will attract penalty extending to Rs 200 per day for period of default or Rs 5,000, whichever is higher.
- Failure to maintain records, pay electronically, issue correct invoices or contravene any other provisions, will attract penalty up to Rs 5,000.
- Scheme will be framed for submission of returns through service tax return preparer.
- Service tax dispute resolution scheme will be introduced for the period July to September 2008 to settle disputes pending as on 1 March 2008 where the service tax arrear is less than Rs 25,000.

## Other key policy initiatives

The Government has proposed various initiatives in the Budget. Some of the key initiatives are as follows:

### Industry

- For the textile industry, the technology upgradation fund scheme will be continued in the eleventh plan and the budgetary allocation for the scheme will be increased from Rs 9.11 billion to Rs 10.90 billion in 2008-09. An additional amount of Rs 4.50 billion will be allocated to the scheme for integrated textile parks.
- For the handloom industry, under the cluster development model for the production and marketing of handloom products, the allocation will be increased to Rs 3.40 billion.
- The allocation to the Department of Information Technology will be increased from Rs 15 billion to Rs 16.80 billion in 2008-09. The Government will also establish 100,000 broadband internet enabled common service centres in rural areas. The Government will also establish state wide area networks and state data centres. The budgetary allocation for

this project will be Rs 0.75 billion for common service centres, Rs 4.50 billion for state wide area networks and Rs 2.75 billion for state data centres.

## Infrastructure

- The Government will award the fourth ultra mega power project and expects to award five more such projects. For the Accelerated Power Development and Reforms Project, the Government will allocate Rs 8 billion in 2008-09. A national fund will also be created for giving impetus to transmission and distribution reforms.
- The Government has notified a coal distribution policy in October 2007 and will appoint a coal regulator.
- For the road transport sector, the budget allocation for NHDP will increase from Rs 108.67 billion to Rs 129.66 billion in 2008-09.

## Financial sector

- Based on recommendations made by the Committee on Financial Inclusion, the Government will advise commercial banks, including RRBs, to add at least 250 rural household accounts every year at each of their rural and semi-urban branches.

## Capital markets

- PAN will be the sole identification number for all transactions in the financial market, subject to threshold exemption limits.
- The Government will take the following additional measures to expand the exchange traded market for corporate bonds:
  - develop bond, currency and derivatives markets by launching exchange traded currency and interest rate futures;
  - develop a transparent credit derivatives market;
  - enhance tradability of domestic convertible bonds by incorporating a mechanism for separation of embedded

equity option and to enable investors to trade them separately; and

- develop a market-based system for classifying financial instruments based on complexity and risk.
- The Government will put in place a mechanism to harmonise the stamp duty payable on securities in different states, with the objective of creating a pan-India market for securities.

## Urban development

- The allocation for the Jawaharlal Nehru National Urban Renewal Mission for urban development will be increased from Rs 54.82 billion to Rs 68.66 billion in 2008-09

## Rural development

- Budgetary support to the Bharat Nirman programme, aimed at building rural infrastructure (roads, houses, irrigation) and bringing basic amenities (water supply, electricity, telecom) to rural India will be increased from Rs 246.03 billion to Rs 312.8 billion in 2008-09.
- The corpus for the Rural Infrastructure Development Fund will be increased to Rs 140 billion for use primarily in the distressed districts of various states. In addition, a separate window for rural roads will be continued with a corpus of Rs 40 billion.
- The Government will initially allocate Rs 160 billion to the National Rural Employment Guarantee Scheme and will cover all the 596 rural districts in India.
- The Government will implement the Rainfed Area Development Programme in 2008-09, with an allocation of Rs 3.48 billion.

## Debt waiver and relief for farmers

- The Government will introduce a new scheme of debt waiver and debt relief for farmers. The total value of loans to be waived under this scheme is estimated at Rs 600 billion.

## Others

- The Government will set up a non-profit corporation to launch world class skill development programmes for imparting skills required by a growing economy. For this purpose, the Government will initially infuse a corpus of Rs 10 billion.
- The Government will allocate Rs 7.5 billion to upgrade additional 300 Industrial Training Institutes into centres of excellence in specific trades and skills under PPP.
- Pending the Unorganised Sector Workers Social Security Bill, three schemes are introduced by the Government to provide social security to workers in the unorganised sector in a phased manner. The total amount allocated for these schemes will be Rs 44.43 billion.
- The budgetary allocation for education and health (including the north east region) will be increased by 20% to Rs 344 billion and by 15% to Rs 165.34 billion respectively.
- The Government will establish 16 central universities and certain other specialised institutes for higher education in various states in 2008-09.
- The total budgetary allocation for the north eastern region will be increased from Rs 143.65 billion to Rs 164.47 billion in 2008-09. An additional sum of Rs 5 billion will be allocated to tackle special problems related to the north east region.
- The Government will provide Rs 164.36 billion as equity support and Rs 30.03 billion as loans to Central Public Sector Enterprises.

# Recent **policy** changes

Significant policy initiatives during the period 1 February 2007 to 31 January 2008 have been summarised in the following paragraphs. Some of these initiatives may be impacted by the proposals announced in the Budget speech of the Finance Minister.

## Foreign investment policy

- FDI in the telecom sector has been revised as follows:
  - Requirement of a ‘serious resident Indian promoter’ holding at least 10% of the equity has been removed.
  - While a majority of the Board of Directors, Chief Officer in charge of technical network operations and Chief Security Officer are still required to be Indian resident citizens, the Chairman, Managing Director, Chief Executive Officer and/ or Chief Financial Officer can now be ‘foreign nationals’.
  - Remote access to the equipment of telecom service companies can be provided to foreign equipment vendors with prior approval from Department of Telecommunications.
- 100% FDI (with prior Government approval) has been permitted in mining and mineral separation of titanium bearing minerals and ores, its value addition and other integrated activities. However, companies will be allowed 100% FDI for mineral separation only if value addition facilities are set up within the country along with transfer of technology and tailings are disposed in accordance with the Rules framed by Atomic Energy Regulatory Board.
- FDI in public sector refineries has been increased from 26% to 49% under the automatic route.
- The Ministry of Commerce & Industry has now clarified that for FDI up to 51% in single brand product retailing, ‘products sold under the same brand internationally’ would mean

‘products that are sold under the same brand in one or more countries other than India’.

# Foreign exchange regulations

## FEMA

- The limit for remittances by resident individuals under the ‘Liberalised Remittance Scheme’ has been increased to USD 200,000 per financial year. This scheme can be utilised to make remittances for permissible current and capital account transactions, subject to prescribed conditions. Direct or indirect remittances to Bhutan, Nepal, Mauritius or Pakistan are not allowed under this scheme.
- The time limit for surrender of foreign exchange received/ realised/ unspent by residents has been amended to a uniform period of 180 days from the date of receipt/ realisation of foreign exchange or from the date of return of the traveller.
- The RBI has clarified that a certificate from a Chartered Accountant and a prescribed ‘undertaking’ from the remitter are required to be submitted to the Assessing Officer at the time of making remittances (inter alia in relation to trade transactions) to non-residents.
- The current limit for remittances (under the automatic route) for any consultancy service procured from outside India has been increased from USD 1 million to USD 10 million per project for Indian companies executing infrastructure projects. For this purpose, the infrastructure sector is defined as power, telecommunication, railways, roads including bridges, sea ports and airports, industrial parks and urban infrastructure (water supply, sanitation and sewage projects).
- The current limit (under the automatic route) for remittances made by an entity in India towards reimbursement of pre-incorporation expenses has been revised from USD 100,000 to higher of the following:
  - 5% of investment brought into India; or
  - USD 100,000.

The AD would allow such remittances on the basis of certification by the statutory auditor.

- ADs have been permitted to allow 'cash call' payments to an 'Operator' either by way of credit to the Operator's foreign currency or Rupee account in India or by remittances overseas, subject to prescribed conditions.

'Operator' refers to a member of a consortium who is exploring oil fields, pursuant to an agreement with the Ministry of Petroleum and Natural Gas. 'Cash calls' are reimbursements to the 'Operator' by other members of the consortium, as per the production sharing agreement.

- ADs have been permitted to open Escrow accounts and Special accounts for non-resident corporates without prior permission of RBI for acquisition/ transfer of shares/ convertible debentures through open offers/ delisting/ exit offers, subject to prescribed conditions.
- Remittances out of assets of Indian companies under liquidation, as per the Companies Act, have been permitted under the automatic route, subject to fulfilment of prescribed conditions.
- SMEs have been allowed to manage their direct and/ or indirect exposures to foreign exchange risk by booking/ cancelling/ re-booking/ roll over of forward contracts without prior permission of RBI, subject to fulfilment of prescribed conditions.
- Resident individuals have been allowed to hedge/ manage their foreign exchange exposures arising out of actual and anticipated inward and outward remittances by booking forward contracts up to a limit of USD 100,000 on the basis of self-declaration under the automatic route, subject to prescribed conditions.
- Domestic oil marketing and refining companies have been permitted to hedge their commodity price risk to the extent of 50% of their inventory, based on the volumes in the quarter preceding the previous quarter, under the automatic route, subject to prescribed conditions including the following:
  - Total forward contracts outstanding should exceed the market value of the portfolio; and

- Forward contracts permitted to be rebooked should not exceed 2% of the market value as determined at the beginning of the financial year.
- FIIs have been permitted to cancel and re-book forward contracts up to an amount of 2% of the market value of the entire investment in equity and/ or debt in India as at the beginning of the financial year. The AD has to ensure that total forward contracts outstanding should not exceed the market value of the portfolio, subject to prescribed conditions.
- In the context of foreign sovereign securities offered as collateral by FIIs, SEBI approved clearing corporations and their clearing members have been permitted to undertake the following transactions, subject to guidelines issued by SEBI:
  - To open/ maintain dematerialised accounts with foreign depositories and to acquire, hold, pledge and transfer the foreign sovereign securities offered as collaterals by FIIs;
  - To remit the proceeds arising from corporate actions, if any, on such foreign sovereign securities; and
  - To liquidate such foreign sovereign securities if required.

## Inbound investments

- FIIs and sub-accounts registered with SEBI are permitted to short-sell, lend and borrow equity shares of Indian companies subject to prescribed conditions. This participation in short-selling, borrowing and lending of equity shares shall be subject to the current FDI policy and shall not be permitted for equity shares which are in the banned list and/ or caution list of RBI.
- With effect from 29 November 2007, equity shares, CCPs and CCDs are required to be issued within 180 days of receipt of consideration from a non-resident investor. In case the securities are not issued within the above period, the amount received is required to be refunded immediately to the non-resident investor unless prior approval of RBI is obtained.

Indian companies which have received such amounts on or before 28 November 2007 for issue of equity shares/ CCPs/ CCDs and have not allotted securities within 180 days of such receipt, are required to approach RBI through the AD with a

definite plan of action ie either to allot shares or refund the money.

- Post 30 April 2007, non-convertible/ partly convertible/ optionally convertible preference shares issued by Indian companies would be covered under the prevailing ECB policy.

Indian companies who were in advance stages of issuing non-convertible/ partly convertible/ optionally convertible preference shares and have taken verifiable and effective steps prior to 30 April 2007 have been given an exemption from the compliance with ECB policy provided they have completed the process of issuing the shares and received money in lieu of such shares by 31 July 2007.

- Non-convertible/ partly convertible/ optionally convertible debentures for which funds have been already received in India on or before 7 June 2007 would be considered under the FDI scheme.

## ECBs

- ECBs availed with Rupee expenditure as an end-use will require prior approval of RBI.
- The ECB policy has been modified to exclude 'development of integrated townships' as a permissible end-use of ECBs.
- The all-in-cost ceiling over 6 months LIBOR for ECBs under the automatic and approval route have been reduced as follows:
  - From 200 basis points to 150 basis points for ECBs with a minimum average maturity period of 3 years to 5 years; and
  - From 350 basis points to 250 basis points for ECBs with a minimum average maturity period of more than 5 years.
- The RBI has increased the pre-payment limit of ECBs up to USD 500 million subject to compliance with the minimum average maturity period applicable to the loan.

## Outbound investments

- The limit for overseas investment by an Indian party in all JVs/ WOS abroad engaged in bonafide business activities has

been increased to 400% of the net worth of the Indian party as on the last audited balance sheet date.

- In the context of overseas investments by an Indian party, 'financial commitment' meant the amount of direct investment by way of contribution to equity, loan and 50% of the amount of guarantees issued by an Indian party to or on behalf of its overseas JVs/ WOS. The term 'financial commitment' has been amended to mean direct investment by way of contribution to equity, loan and the total amount of guarantees by the investing company, promoter company, group company, sister concern or associate company/ partnership firm in India.
- Acquisition of shares of a foreign company engaged in a bonafide business activity by an Indian entity in exchange of ADRs/ GDRs issued to such foreign company, shall be considered as an accepted mode of overseas direct investment and shall be subsumed under the limit specified for overseas investment ie 400% of net worth of the Indian entity subject to prescribed conditions.
- Indian Parties availing fund based and non-fund based facilities overseas have been permitted to transfer by way of pledge, the shares held in an overseas JV/ WOS, to an overseas lender subject to the following conditions:
  - The lender is regulated and supervised as a bank outside India; and
  - The total financial commitment of the Indian party remains within the limit stipulated by RBI for overseas investment.
- Mutual funds registered with SEBI have been permitted to invest in the specified instruments like:
  - ADRs/ GDRs issued by Indian or foreign companies;
  - Initial and follow-on public offerings, as well as listed equity of overseas companies on recognised stock exchanges overseas;
  - Units/ securities issued by overseas mutual funds or Unit Trusts registered with overseas regulators, and investing in (a) the aforesaid securities (b) REITs listed in recognised stock exchanges overseas or (c) unlisted overseas securities (not exceeding 10% of their net assets).

- The limit for Indian listed companies to make portfolio investments overseas has been increased from 35% to 50% of the net worth of the investing company as on the date of its last audited balance sheet. Portfolio investments for this purpose would include shares and rated bonds/ fixed income securities rated not below investment grade by accredited/ registered credit rating agencies, issued by listed overseas companies subject to certain conditions. Further, the requirement of reciprocal 10% investment in listed Indian companies has been removed.
- Resident entities with overseas direct investments are permitted to hedge the exchange risk arising out of such investments by entering into forward/ option contracts. The resident entities have been allowed to cancel such forward contracts and 50% of such cancelled contracts have been allowed to be re-booked.

## Imports/ Exports

- ADs have been empowered to grant extensions up to a period of 6 months at a time, irrespective of the value of the invoice, for realization of export proceeds beyond the prescribed period from the date of export, subject to prescribed conditions.
- Status holder exporters have been permitted to write-off outstanding dues subject to a limit of higher of the following amounts:
  - 5% of their average annual realisation during the preceding 3 financial years; or
  - 10% of the export proceeds due during the relevant financial years.
- The overseas offices/ branches of a software export company/ firm were hitherto required to repatriate 100% of the contract value of each off-site contract and at least 30% of the contract value of each on-site contract. The requirement of repatriation of 30% of contract value of each on-site contract has been dispensed with. However, the overseas offices/ branches are required to repatriate the profits of the on-site contract after completion of the said contract.
- The limit for reduction of invoice value by ADs for exporters has been increased from 10% to 25% of the invoice value, subject to fulfilment of prescribed conditions.

- The ceiling limit for hedging of foreign exchange exposure by exporters/ importers has been increased from 50% to 75% of the 'eligible' amount.
- EEFC account holders have been allowed to maintain outstanding balances to the extent of USD 1 million in the form of interest bearing term deposits up to 1 year, provided the same are maturing on or before 31 October 2008.
- BPO companies in India have been permitted to make remittances towards the cost of equipment to be imported and installed at their overseas sites in connection with setting up their ICC subject to fulfilment of prescribed conditions.

## NRI/ PIOs

- Remittance of the maturity proceeds of FCNR(B) deposits to third parties outside India has been permitted under the automatic route provided the transaction is specifically authorised by the account holder and the AD is satisfied about the bonafides of the transaction.
- ADs have been permitted to grant Rupee loans to NRI employees of Indian companies for buying shares under an ESOP scheme subject to prescribed conditions.

# Securities law and regulations

## Listing Agreement

- Clause 41 of the Listing Agreement has been amended. The key amendments are as follows:
  - Variance of 10% or Rs 1 million in respect of (a) net profit or loss after tax and (b) exceptional/ extraordinary items, needs to be explained (previously every item with a variance of 20% or more had to be explained).
  - A company having subsidiaries is mandatorily required to submit annual audited consolidated financial results to the stock exchanges. As regards quarterly results, it is required to submit and publish quarterly stand alone financial results. However, it has the choice to submit quarterly consolidated

financial results in addition to the stand alone results.

Where this choice is made, the company has the option to publish in newspapers either stand alone or consolidated financial results. This option of publication once exercised cannot be changed during the financial year.

- Clause 49 of the Listing Agreement has been amended by requiring the monitoring agency to file its issue proceeds utilisation report with the issuer company which will then place it before its Audit Committee. Any material deviations in the utilisation of issue proceeds need to be informed to the stock exchange and to the public through newspaper advertisement (earlier a report was required to be filed with SEBI).

## SEBI (Disclosure and Investor Protection) Guidelines, 2000

- Companies with listing history of less than 6 months can also raise money through preferential allotment. However, on completing a period of 6 months of being listed on a stock exchange, the company shall recompute the price of the shares as per prescribed guidelines and if the price at which shares were allotted on a preferential basis was lower than the price so recomputed, the difference shall be paid by the allottees to the company.
- A company desirous of making a QIP shall now be required to have a listing history of at least 1 year as on the date of issuance of notice to its shareholders for convening a general meeting in terms of the Companies Act to consider the QIP.
- Securities which have been pledged with banks or financial institutions as collateral security for loans granted by such banks or financial institutions shall not be eligible for computation of minimum promoter's contribution.
- Companies making public issues are now permitted to issue securities to retail individual investors at a discounted price, provided that such discount does not exceed 10% of the price at which securities are issued to other categories of investors.
- Grading of all IPOs has been made mandatory. The grading shall be done by credit rating agencies registered with SEBI under the SEBI (Credit Rating Agencies) Regulations, 1999. Grading from at least one credit rating agency needs to be obtained.

- Provisions relating to FTIs have been introduced for listed companies making a follow on public offer/ rights issue.

## Others

- The concept of Consent Orders by SEBI has been introduced in order to provide the flexibility of a wider array of enforcement actions without resorting to a long drawn litigation before SEBI/ Tribunal/ Courts.

# Corporate law

## Indian Depository Receipt Rules

- The Companies (Issue of IDR) Rules, 2004 has been amended. The key amendments are:
  - Issuing company should have a pre-issue paid-up capital and free reserves of at least USD 50 million (instead of USD 100 million) and a minimum average market capitalization of at least USD 100 million (instead of average turnover of USD 500 million) during the last 3 years in its parent country.
  - Continuous trading record or history on a stock exchange in its parent country for at least 3 immediately preceding years has been introduced.
  - Track record of distributable profits in terms of section 205 of the Companies Act for at least 3 years (instead of 5 years) out of immediately preceding 5 years.
  - The number of underlying equity shares offered in a financial year through IDR offerings shall not exceed 25% (instead of 15%) of the post issue number of equity shares of the company.
  - The earlier conditions of declaration of minimum rate of dividend (10%) for 5 years and a minimum debt-equity ratio of 2:1 have been omitted.

# Financial Services

## Mutual funds

- With a view to liberalise overseas investments by Indian mutual funds into ADRs/ GDRs/ foreign securities:
  - The aggregate limit of overseas investments by Indian mutual funds into ADRs/ GDRs/ foreign securities has been enhanced from USD 3 billion to USD 5 billion.
  - The limit of 10% of the net assets managed by a mutual fund as on March 31 each year continues to apply, however, the maximum investment limit has been enhanced from USD 150 million to USD 300 million per mutual fund.
  - The asset classes in which investment can be made by mutual funds have been expanded.
- In order to ensure that the funds collected in mutual fund schemes are invested as per the investment objective stated in the offer document, SEBI has issued guidelines for parking of funds (prior to deployment) by mutual funds in short-term deposits of scheduled commercial banks.
- Mutual funds have been permitted to engage in short-selling of securities as well as lending and borrowing of securities in accordance with the framework relating to short-selling and securities lending and borrowing specified by SEBI.
- SEBI has specified lower limits on investment and advisory fees and total expenses in the case of index fund schemes including exchange traded index funds. The investment and advisory fees in the case of an index fund scheme shall not exceed 0.75% of the weekly average net assets. Further, the total expenses of the scheme (including the investment and advisory fees) shall not exceed 1.5% of the weekly average net assets.
- With effect from 4 January 2008, no entry load will be charged for direct applications received by an AMC ie applications received through internet, submitted to AMC or collection centre/ investor service centre that are not routed through any distributor/ agent/ broker. This applies to investment in existing schemes and new schemes launched after the aforesaid date.

- With effect from 31 January 2008, close-ended mutual fund schemes are required to meet the sales, marketing and other expenses connected with sales and distribution of schemes from the entry load. Such schemes will not be permitted to charge and amortize initial issue expenses.

## FIIIs/ sub-accounts

- On review of the policy relating to the issuance of PNs/ ODIs with Indian securities as the underlying, SEBI announced the following policy changes with effect from 25 October 2007:
  - FIIIs and their sub-accounts cannot issue/ renew PNs/ ODIs with underlying as derivatives with immediate effect. Existing positions are required to be wound up over 18 months.
  - FIIIs with notional value of PNs/ ODIs outstanding (excluding derivatives) equal to or greater than 40% of their AUC in India would not be permitted to issue fresh PNs/ ODIs except against cancellation/ redemption/ closing out of existing PNs/ ODIs.
  - FIIIs with notional value of PNs/ ODIs outstanding (excluding derivatives) less than 40% of their AUC in India would be permitted to issue fresh PNs/ ODIs at an incremental rate of 5% annually until such issuance reaches 40% of the AUC pursuant to which fresh PNs/ ODIs can be issued only against cancellation/ redemption/ closing out of existing PNs/ ODIs of at least equivalent amount.
  - Issuance of PNs/ ODIs has been restricted to regulated entities as against registered entities.
- With effect from 31 January 2008, SEBI has announced the following changes with respect to FII investments in debt securities:
  - The aggregate ceiling of debt investments by FIIIs/ sub-accounts in Government securities and T-bills has been enhanced from USD 2.6 billion to USD 3.2 billion.
  - Investments by FIIIs/ sub-accounts in debt oriented mutual fund units is to be considered as corporate debt investments and reckoned within the stipulated limit of USD 1.5 billion for investments in corporate debt by FIIIs/ sub-accounts.

- No further investment, or rollover, of existing positions is to be permitted in corporate debt, by both 100% debt FII and 70:30 route FIIs, till the existing holdings fall within the stipulated limit of USD 1.5 billion.

## Venture capital funds

- SEBI registered VCFs have been permitted to invest in equity and equity linked instruments of offshore venture capital undertakings, subject to overall limit of USD 500 million and with prior SEBI approval. Investments can be made only in those companies which have an Indian connection and the investment cannot exceed 10% of the VCFs investible funds.

## Banks

With a view to provide a wider choice of instruments to Indian banks for raising capital, RBI has allowed banks to issue following types of preference shares in Indian rupees as per prescribed guidelines:

- Perpetual non-cumulative preference shares that will be regarded as Tier I capital.
- Perpetual cumulative preference shares, redeemable non-cumulative preference shares, redeemable cumulative preference shares that will be regarded as Tier II capital.

The guidelines cover matters regarding terms of issue, reserve requirements, reporting requirements, investments in preference shares issued by other banks/ financial institutions and grant of advances against the preference shares.

## Health Sciences

### Price control

- The NPPA has revised its guidelines for prices of non-scheduled formulations such that if the price increase is more than 10% during a period of 12 months and annual turnover of the formulation pack exceeds Rs 10 million, the concerned manufacturer would be asked to furnish reasons for such increase or to bring down the prices voluntarily and to thereafter maintain the price level within the 10% band. This ceiling of 10% is effective from 1 April 2007.

## Proposed legislation

- The Drugs and Cosmetics (Amendment) Bill, 2007 proposes to:
  - Set up a Central Drugs Authority reporting directly to the Ministry of Health and Family Welfare.
  - Introduce centralised licensing for manufacture of drugs.
  - Grant permission for clinical trials, punishment for conducting clinical trial without permission, trial of offences, etc.
- The Clinical Establishments (Registration and Regulations) Bill, 2007 proposes to:
  - Register, regulate and set standards for clinical establishments.
  - Establish a National Council whose main functions will include prescribing standards for clinical establishments and maintaining a register of clinical establishments.
  - Register every clinical establishment. The Bill provides for both provisional registration and permanent registration upon satisfaction of prescribed conditions.

## Biotechnology parks

- Several states such as Kerala and Gujarat have formulated a Biotechnology Policy. These policies envisage development of biotech clusters in the form of zones/ estates, development of specific parks/ SEZs and specific strategic actions for development of the Biotech sector.

## Technology

### Semi-conductors

- The Government has introduced a Special Incentive Package Scheme with a view to create a conducive environment for semi-conductor manufacturing in India.
- The key features of this Incentive Scheme are as follows:

- It is intended to cover state-of-art technology and manufacture of all semi-conductor and related ecosystem products, as well as assembly and testing of these products.
- The Government will bear 20% of the capital expenditure incurred during the first 10 years in respect of units located in SEZs and 25% of the capital expenditure, in case of non-SEZ units.
- Non-SEZ units will be exempted from the levy of CVD on capital goods through a separate notification.
- An option is available to the units to claim the incentives either in the form of capital subsidy (through investment grants and interest subsidy) or equity participation by the Government.
- An overall ceiling on the number of ‘fab units’ and ‘ecosystems’ has been prescribed under this Scheme.
- Incentives under this Scheme will be available only if applications are made by 31 March 2010.
- The detailed guidelines for operation of this Incentive Scheme inter alia provide:
  - Submission of proposal by the investor along with a feasibility report and an application fee (non-refundable) of Rs 2.5 million;
  - Only technologically sound, large projects promoted by professionally qualified, financially sound and reputed players with a proven track record shall be eligible;
  - Final approval of the Project shall vest with the Government.

## Information technology

- The IT Act was reviewed by a Standing Committee of the Parliament. Based on recommendations made by the Standing Committee/ DIT, the amendments suggested include:
  - Developing an International Convention to address global cyber crimes/ cyber terrorism with the support of the United Nations.

- Simplification of the adjudication process and making cyber offences cognizable.
- Facilitating audit of electronic records and initiating necessary steps towards data protection and retention.

## Infrastructure and Transportation

- AERA of India Bill, 2007, has been introduced in Parliament on 5 September 2007. The AERA will be responsible for fixing, reviewing and approving the tariff structure for aeronautical services, user development fees and monitoring the set performance standards relating to quality, continuity and reliability.
- The Shipping Ministry has introduced a new dredging policy, effective 1 April 2007 which is valid up to 31 March 2010. The policy states that all 13 major ports shall invite open competitive bids for dredging works, and Indian companies owning Indian flag dredgers shall have the right of first refusal if the rate is within 10% of the lowest valid offers.
- Merchant Shipping (Amendment) Bill, 2007 which provides for an International Code for the security of ships and port facilities has been passed by both the Houses of Parliament and has received the President's assent.
- The Government has approved the Model Concession Agreement for public-private partnerships for major ports. The new agreement replaces the model license agreement of March 2000.
- The Government has introduced the Carriage by Road Act, 2007, to regularize common carriers and limit the liability of the carrier on account of loss incurred due to their negligence or negligence of their agent.
- In July 2007, the Government notified rules for disbursement of the Central Road Fund in respect of specified projects, schemes and activities relating to development and maintenance of roads.
- In March 2007, the Government approved the signing and ratification of the Inter-Governmental Agreement on Trans-

Asian Railways. The agreement envisages connecting a rail network of around 81,000 kilometres across Asia and Eastern Europe.

- The Government has finalised the new Toll Policy and is in the process of formulating Toll Rules.

## Insurance

- Presently, no life insurer is permitted to declare bonus to the policy holders except out of surplus shown in the Life Fund. The IRDA had however, permitted such bonus to be declared for the first five years of operation of the insurance company even where the Life Fund was in deficit. In light of the long gestation period involved in earning of surplus by insurance companies, the IRDA has extended the applicability of these provisions for the funding of the Life Fund for payment of bonus to the policy holders to the first 7 years of operation of the life insurance company.
- As per the Insurance Act, 1938, every general insurance company is required to cede (re-insure) a prescribed percentage of the sum assured on each policy for different classes of insurance written in India with an Indian re-insurer (currently, the General Insurance Corporation of India is the sole re-insurance company in India). Such rate of mandatory cession as prescribed by the IRDA has been reduced from 20% to 15% in respect of insurances attaching during the year 1 April 2007 to 31 March 2008 and further reduced to 10% in respect of insurances attaching during 1 April 2008 to 31 March 2009.
- In order to enhance flexibility in the operation of ULIP, the restriction on investments in money market investments has been increased from 20% of the total funds (for each policy holder) to 40%.
- Pursuant to removal of controls on pricing of risks in general insurance business, full pricing freedom has been accorded to the general insurance companies for all new insurance and renewal risks (except for motor insurance third party business) effective 1 January 2008. Thus, general insurance companies shall be free to quote rates of premium in accordance with the rate schedules and rating guidelines that have been filed with the IRDA.

# Media

## Interconnection (Fourth Amendment) Regulation, 2007

- The Government has issued The Telecommunication (Broadcasting and Cable Services) Interconnection (Fourth Amendment) Regulation, 2007 effective from 1 December 2007.
- Key aspects of the regulation are:
  - Every broadcaster to intimate its Reference Interconnect Offer specifying technical and commercial terms and conditions to all the DTH operators and publish the same on its website.
  - Compulsory offering of channels on a-la-carte basis.

## The Direct to Home Broadcasting Services (Standards of Quality of Service and Redressal of Grievances) Regulations, 2007

- These regulations, effective from 1 December 2007 address quality standards and procedures with respect to connection and disconnection of DTH services.
- Key aspects of the regulation are:
  - DTH operators to provide DTH Customer Premises Equipment on outright purchase basis, hire purchase basis or rental basis at the option of the consumer.
  - Prohibition to disable DTH set-top boxes in case the consumer wants to avail services of another DTH operator.

## Amendment to DTH guidelines

- The DTH guidelines have been amended vide order dated 10 September 2007, to the effect that penal provisions would be attracted if the DTH service provider fails to carry the channels

for mandatory transmission under the Cable Television Network (Regulation) Act, 1995.

- The Government vide an order effective from 6 November 2007 has set out timelines for payment of license fee by the DTH operators and also provided for payment of interest in case of excess/ shortfall of payment within the timelines.

## Broadcasting Bill, 2007

- The Broadcasting Bill, 2007 (on the same lines as the Broadcasting Bill, 2006), has amended the definition of broadcasting to exclude broadcasting on computer networks and additionally provides for establishing Public Service Broadcasting Council for regulating public service broadcasting.

## The Sports Broadcasting Signals Ordinance and Rules

- The said Ordinance and Rules provide for mandatory sharing of the live broadcasting signals and advertisement revenues of sporting events of national importance with Prasar Bharti.

## Mining

- The royalty rates on production of coal and lignite have been revised with effect from 1 August 2007.
- Export duty on iron ore with iron content of 62% and below has been reduced from Rs 300 per ton to Rs 50 per ton.

## Oil and gas

- In continuance with the Government's recommendation for oil companies to implement 5% ethanol blending, which was optional for individual states, a Group of Ministers has recommended 10% blending of ethanol to be made mandatory by October 2008 for all the states except for Jammu & Kashmir, the north-eastern states, Andaman and Nicobar Islands, and Lakshadweep Islands.

- The PNGRB was established with effect from 1 October 2007 under the PNGRB Act, 2006. The Board has been recently constituted with the objective of regulating the refining, processing, storage, transportation, distribution, marketing and sale of petroleum, petroleum products and natural gas, excluding production of crude oil and natural gas. The Board would also have the authority to:
  - Lay down the maximum transportation tariffs for common carriers, or contract carriers or a city or local natural gas distribution network; and
  - Decide the period of exclusivity for city gas distribution networks.
- CGD in India forms a small portion of entire natural gas consumption in India but is projected to grow significantly in the future. To promote the efficient development of CGD networks, the PNGRB has proposed a draft policy for the development of city or local gas distribution networks. The policy, inter alia, proposes to bring regulatory clarity on important aspects governing authorisation of CGD networks, exclusivity periods for CGD networks and network tariffs.

## Other developments

- The NELP VII round was launched on 13 December 2007. The Directorate General of Hydrocarbons has identified 57 blocks. The offered blocks include 19 deep water, 9 shallow water and 29 on land blocks.

## Power

- The Electricity (Amendment) Act, 2007 is in force with effect from 15 June 2007. The key amendments are:
  - No licenses required for supply from captive units.
  - Deletion of the provision for elimination of cross subsidies.
  - Central Government, jointly with State Governments, to endeavour to provide electricity to all areas including villages through rural electricity infrastructure and electrification of households.

- Definition of theft expanded to cover use of tampered meters and use for unauthorised purpose.
- The CERC has, in December 2007, come out with draft regulations on new open access norms to facilitate trading through the power exchange and has invited comments.

The CERC granted approval on 31 August 2007 to Financial Technologies (India) Limited and the Multi Commodity Exchange to set up and operate a power exchange. National Thermal Power Corporation and National Commodity and Derivative Exchange are also in the process of forming a joint venture company to launch a power exchange.

- The Government has approved a new Coal Distribution Policy in October 2007. Under the policy, the power and fertilizer sector will get assured coal supply at a predetermined price under fuel supply agreements.
- APDRP, originally launched in year 2001 to accelerate distribution sector reforms, is being revised. Under the proposed APDRP, the evaluation period and process parameters (for instance, in respect of reduction of losses) has been revised from 1 year to 5 year basis.

## Retail and consumer products

- The Central Government has introduced the Model State Agricultural Produce Marketing (Development and Regulation) Rules, 2007, dealing with inter-alia, the following:
  - Constitution, appointment, composition, conduct and election of Market Committee;
  - Contract farming; and
  - Establishment and functioning of private market/ private e-market, consumer/ farmer market and direct purchase.

# SEZ

The Ministry of Commerce has been issuing guidelines/clarifications from time to time with regard to operation of SEZs and units set up therein. Some of the key amendments are:

- Effective 10 October 2007, the SEZ Rules 2006 have been amended. The key amendments are:
  - Maximum area for a multi-product SEZ capped at 5,000 hectares (approximately 12,000 acres).
  - Percentage of minimum processing area in a multi-product SEZ increased from 35% to 50%.
  - Restriction on transfer of old plant and machinery, previously used in a Domestic Tariff Area to a SEZ Unit, has been removed. Development Commissioners to ensure that procurement of second hand capital goods shall be allowed only where such second hand capital goods form not more than 20% of plant and machinery of the SEZ unit.
- Specified SEZs notified by the Ministry of Commerce shall be deemed to be 'Inland Container Depots' under the Customs Act, 1962.

# Indirect Tax

## Service tax

- Export of Service Rules, 2005 amended to replace the condition of 'delivered outside India' and 'used outside India' with the condition of a service 'provided from India' and 'used outside India' for a service to qualify as 'export of service' effective 1 March 2007.
- Certain services received by an exporter for export of goods have been exempted from service tax by way of a refund to the exporter subject to fulfilment of prescribed conditions.

## Excise duty

- MRP valuation for the purpose of levy of excise duty is extended to certain telecom and IT goods such as printer, ink

cartridges, modems, monitors for ATMs, computers and set-top boxes. Excise duty on such products shall be levied on the retail sales price (less prescribed abatement percentage) with effect from 25 January 2008.

- Area specific excise duty exemptions in Uttarakhand or Himachal Pradesh will not be available to manufacturing units which are merely carrying out certain specified processes such as preservation during storage, cleaning operations, packing or repacking of goods in a unit container or labelling or relabelling of containers, sorting and declaration or alteration of retail sale price.

## Customs duty

- The Intellectual Property Rights (Imported Goods) Enforcement Rules, 2007 have been notified. These rules aim to provide the holder of IPR protection from import of goods which are infringing the IPR.
- New customs valuation rules for import and export of goods were notified, effective from 10 October 2007.
- BCD on specified wines and other fermented beverages has been increased to 150% and additional customs duty on alcoholic beverages has been exempted. Further, education cess on customs duty on wines and other fermented beverages is abolished.
- The duty drawback rates for 2007-08 have been notified. The drawback rate has been increased on most of the specified goods.
- SAD exempted on goods imported into India for the purpose of subsequent sale. The exemption is provided by way of refund subject to fulfilment of prescribed conditions.
- Customs duty on goods imported under various Free Trade Agreements has been reduced. The key changes are:
  - BCD on goods imported under the CECA has been further reduced. Duty exemption on BCD has been increased from the existing 25% and 10% to 50% and 20% respectively on notified goods.

- Duty exemption under CECA has also been extended to certain additional goods with effect from 15 January 2008.
- BCD has been reduced on products imported under the South Asia Free Trade Area Agreement from SAARC Countries namely, Bangladesh, Bhutan, Maldives, Nepal, Pakistan and Sri Lanka.
- Customs duty concession on specified goods imported under the India-Chile Preferential Trade Agreement and the relevant rules of origin were notified. Concession of BCD ranges from 10% to 50%.

## VAT/ CST

- VAT has been introduced in Pondicherry and Uttar Pradesh effective 1 July 2007 and 1 January 2008 respectively. With this, all states in India have shifted to the VAT regime.
- In case the buyer does not issue a Form C, the applicable rate would be the local VAT in the selling state (which is generally 4% or 12.5%).
- The provision permitting concessional inter-state purchases by the Government against Form D has been withdrawn.

## Foreign trade policy

- The third annual supplement to the FTP for 2007-08 was announced in April 2007. Some of the key proposals of the supplement are:
  - ‘High Tech Products Export Promotion Scheme’ introduced for specified high tech products.
  - Exporters of such products will be entitled for duty credit scrip equivalent to 10% of incremental growth in exports of notified products.
- The following changes have been announced under the annual supplement to the FTP:
  - DEPB Scheme has been extended till 31 March 2008.

- Focus Product Scheme has been extended to new products and the Focus Market Scheme has extended to cover 16 new countries including 10 CIS countries. The scheme is also extended to the Export Oriented Units, provided they do not claim direct tax benefit.
- Duty credit scrips earned under the SFIS can no longer be used for payment of duty in case of import of capital goods under lease finance.
- An applicant will be entitled to interest in case of delay in payment of refund of terminal excise duty or duty drawback.
- DEPB Scheme, Duty Free Import Authorisation Scheme and Advance Authorisation Schemes would be available for suppliers to notified Developers and Co-developers of SEZs, irrespective of currency of realisation.

# Glossary

AD	Authorised Dealer
ADR	American Depository Receipt
AERA	Airport Economic Regulatory Authority
AMC	Asset Management Company
AOP	Association of Persons
APDRP	Accelerated Power Development Reform Program
ATM	Automated Teller Machine
AUC	Assets Under Custody
BCD	Basic Customs Duty
BCTT	Banking Cash Transaction Tax
BED	Basic excise duty
BOI	Body of Individuals
BPO	Business Process Outsourcing
BSE	Bombay Stock Exchange
CBDT	Central Board of Direct Taxes
CCDs	Compulsorily Convertible Debentures
CCP	Code of Criminal Procedures, 1973
CCPSs	Compulsorily Convertible Preference Shares
CEA	Central Excise Act, 1944
CECA	Comprehensive Economic Cooperation Agreement between India-Singapore
CENVAT	Central value added tax

CERC	Central Electricity Regulatory Commission
CETA	Central Excise Tariff Act, 1985
CGD	City Gas Distribution
CIS	Commonwealth of Independent States
Commissioner	Commissioner of Income-tax
Companies Act	Companies Act, 1956
Credit Rules	Cenvat Credit Rules, 2004
CST	Central Sales Tax
CVD	Countervailing Duty
DDT	Dividend distribution tax
DEPB	Duty Entitlement Pass Book
DIT	Department of Information Technology
DTA	Domestic tariff area
DTH	Direct-to-Home
ECBs	External Commercial Borrowings
EEFC	Exchange Earner's Foreign Currency
EHTP	Electronic hardware technology park
EOU	Export oriented unit
ESOP	Employees Stock Option Plan
EU	European Union
FBT	Fringe Benefit Tax
FCEB	Foreign Currency Exchangeable Bonds
FCNR(B)	Foreign Currency Non Resident (Bank)
FDI	Foreign Direct Investment

FEMA	Foreign Exchange Management Act, 1999
FII	Foreign Institutional Investor
FRBMA	Fiscal Responsibilities and Budget Management Act, 2003
FTI	Fast Track Issues
FTP	Foreign Trade Policy 2004-2009
GDP	Gross Domestic Product
GDR	Global Depository Receipt
HUF	Hindu Undivided Family
ICC	International Call Centre
IDR	Indian Depository Receipt
Income-tax Act	Income-tax Act, 1961
IPC	Indian Penal Code, 1860
IPO	Initial Public Offer
IPR	Intellectual Property Rights
IRDA	Insurance Regulatory and Development Authority
IT	Information Technology
IT Act	Information Technology (Amendment) Act 2006
ITAT	Income Tax Appellate Tribunal
ITES	Information Technology Enabled Services
KWH	Kilo watts per hour
JV	Joint Venture
LCD	Liquid Crystal Display
LIBOR	London Inter Bank Offer Rate

MAT	Minimum alternate tax
MRP	Maximum Retail Price
MT	Metric Tonne
NCCD	National calamity contingent duty
NELP	New Exploration Licensing Policy
NPPA	National Pharmaceutical Pricing Authority
NRO	Non Resident Ordinary Rupee Account
NRIs	Non-resident Indians
NSE	National Stock Exchange
OLED	Organic Light Emitting Diodes
PDP	Plasma Display Panels
PF	Provident Fund
PIOs	Persons of Indian Origin (not resident in India)
PN/ ODI	Participatory Note/ Offshore Derivative Instrument
PNGRB	Petroleum and Natural Gas Regulatory Board
POA	Power of Attorney
PSU	Public Sector Undertaking
QIP	Qualified Institutions Placement
RBI	Reserve Bank of India
REITs	Real Estate Investment Trusts
SAARC	South Asian Association for Regional Cooperation
SACD	Special additional customs duty
SAD	Special Additional Duty

SEBI	Securities and Exchange Board of India
SEZ	Special Economic Zone
SFIS	Served From India Scheme
SMEs	Small and Medium Enterprises
STP	Software technology park
STPI	Software Technology Parks of India
STT	Securities Transaction Tax
SUUTI	Special Undertaking of Unit Trust of India
ULIP	Unit Link Insurance Plan
USD	US Dollar
VAT	Value Added Tax
VCF	Venture Capital Fund
VCU	Venture Capital Undertaking
Wealth Tax Act	Wealth Tax Act, 1957
WOS	Wholly Owned Subsidiary
WPI	Wholesale Price Index

# Notes

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