Tax implications expected from the Union Budget 2019

Before we get in the likely tax implications of the Union Budget, let us remember that this is an interim budget and not a full-fledged budget. Why is that relevant. Normally, major changes to direct taxes are not undertaken in an interim budget considering the limited tenure of the government. At best there is some tweaking that is done on the personal tax front. One of the key expectations on the personal tax front is that the basic exemption slabs may be revised while the benefits under Section 80C and Section 24 may be revised upwards. The government may ideally look to wait till the actual budget to implement this. However, where we do believe some action will be taken is on announcement made on the capital gains tax in the previous budget. The government does need robust markets to go through with its divestment program and that could be on big incentive. Let us look at four areas of likely direct tax outcomes from the Union Budget 2019.

How about some special tax incentives for disinvestment

The problem for the government is that the GST revenues may be under pressure till the entire system stabilizes. This fiscal, the GST collections are likely to be below the target by Rs.1 trillion. That is a big gap to be filled up. Good market conditions may be one side of the story. Another way would be to gives special tax incentives for buying into disinvested into shares. On the one hand, the market needs a constant supply of quality paper to ensure that valuations do not go out of sync with reality. That can only come from a consistent divestment program.

What the government needs to do is to extend the benefits of Section 80C for investments in disinvested shares and carve a special limited period exemption for individual investors. That would work better than giving price discounts to the retail investors. The government can also look to transfer the strategic sale assets to an SPV or ETF and then give special incentives to retail investors for investing in the same. These can give a big boost to the divestment program that is currently stuck. By combining stake sale in PSUs with strategic sale and monetizing government assets through the market route, the government can substantially expand the supply of quality paper in the market.

What is the government expected to do with LTCG tax introduced last year

Actually, the markets are right because there is a clear case of cascading of taxes on capital gains at multiple levels. Take the case of capital gains on equity. Firstly, STT was introduced in lieu of long term capital gains tax. Last year, by introducing tax on LTCG on equities and continuing with STT it has translated into a dual tax on the investors. In addition, the third level of tax comes from the flat tax on long term gains, which means that the benefit of indexation will not be available. Since this hits direct equities and equity funds, it also impacts the long term plans of savers. At the very minimum, the benefit of indexation be reintroduced for equity gains or the rate of taxation can be reduced to just 5%. In fact, the government can also do away with LTCG tax altogether. That would make the disinvestment incentives more popular and meaningful for investors.

There is an urgent need to reduce the multiple levels of tax on dividends

Dividends that are declared and paid out by Indian companies are being taxed at multiple levels, which is synonymous to cascading multiple-taxation. To begin with, dividends are a post tax appropriation and so the tax benefit is not available for the company paying dividends. In addition, there is dividend distribution tax (DDT) that is imposed at 15% of the gross dividends paid by the company. The big googly came when the Union Budget 2016 introduced a 10% tax on dividends in the hands of the recipient above Rs.10 lakhs per year. Also there is now DDT on equity mutual funds too. This budget has to take urgent steps to sharply reduce the cascading effect of taxation on dividends.

Can we have an ELSS equivalent for direct equity investments?

Today the only benefit that investors get on equities is the Section 80C benefit available on ELSS investments. Considering the low spread of equity cult in India and a young population desperately needing to save, equity needs a big push as an asset class. What the government can do is to give flat incentives on IPO investments, divestments, strategic sale SPVs, PSE ETFs etc. This will not only smooth the divestment process for the government but also give retail investors access to quality paper at reasonable prices. Of course, such equity incentives can be time-bound to reduce the pressure on the exchequer.