



17 TAXATION → FINANCE COMMISSION (वित्त आयोग)

Article 280: President of India forms a Finance Commission (a quasi judicial body) every 5th Year or earlier, with 1 chairman and four members. Eligible for re-appointment.

Recommendations are not binding on the government but usually they are not rejected.

Further self-study@ M.Laxmikanth's Indian Polity ch.45.

14th FC: YV Reddy	Recommendation Period: 1st April, 2015 to 31st March, _ _ _ _
15th FC: NK Singh	Recommendation Period: 1st April, 2020 to 31st March, _ _ _ _

17.1 VERTICAL TAX DEVOLUTION FROM UNION TO STATES

संघ से राज्यों तक कर का सीधा हस्तांतरण

- Finance commission will recommend the vertical devolution from the 'divisible pool' of union taxes. (Here, CGST, Cess, Surcharge not counted.)
- 12th Rangarajan: 30.5%, 13th Vijay Kelkar: 32%, 14th Y.V. Reddy: _ _ %, 15th NK Singh: _ _ % (Homework update when report is released).

17.2 HORIZONTAL TAX DISTRIBUTION AMONG STATES

राज्यों के बीच समस्तरीयकर वितरण

Finance Commission also gives formula for How to distribute that share horizontally with individual States (Guj | Bihar | MH | TN...). 14th FC (YV Reddy)'s formula was...

14th FC horizontal distribution formula components		Weight %
आबादी	Population: as per Census 1971	17%
जनसांख्यिकीय बदलाव	Demographic Change as per Census 2011 (To consider the migration angle.)	10%
आय-दूरी	Income-Distance: <ul style="list-style-type: none"> - Find the best State of India in per capita income (GSDP ÷ its population). - Compare your state's per capita income with them. Accordingly, poorer states get more weight	_ _ %
क्षेत्र	Area: more area more weight	15%
वन-आवरण	Forest-Cover: more forest cover more weight because of <i>Opportunity cost</i> (State can't allow industries there, else it could have obtained some taxes)	8%

Based on above formula, Highest to Lowest: _ _ _ _ _ > Bihar > MP > WB > MH > Raj > > Mizoram > Goa > Sikkim.

17.3 GRANTS FROM UNION TO STATES संघ से राज्यों को अनुदान

Apart from the tax devolution and tax distribution, the finance commission would also suggest Union to give grant to the states (grant: NOT loan, so need not return with interest).

14th FC suggested three types of grants→



1. **For All States:** Grants for Panchayati Raj Institutions (PRI) and Urban Local Bodies (ULB). These grants will be subdivided into two parts: basic grant and (10-20%) performance based grants.
2. **For All States:** Disaster Management Grants.
3. **For 11 (कंगाल) States:** Post-Devolution Revenue Deficit Grants for ~11 States.

17.4 FIFTEENTH FC COMPOSITION (SETUP IN 2017-NOV)

Chairman	_____ (Retd. IAS, Ex-Member of Parliament)
Member1	_____ (Retd. IAS, RBI Gov)
Member2	Dr. Anoop Singh, Professor
Member3 (Part Time)	Dr. Ashok Lahiri, Bandhan Bank
Member4 (Part Time)	Prof. Ramesh Chand. He's member of NITI Aayog & Agri Economist.
Secretary	Arvind Mehta (IAS)

Deadline? 15th FC has to give report by 30th October, 2019.

Validity? From 1st April, 2020 to 31st March 2025.

17.4.1 15th FC Terms of Reference (TOR: विचारार्थ विषय)?

President of India has ordered them to study and recommend following:

1. Union Taxes' Vertical devolution to the states, and its horizontal distribution among the states. (except cess, surcharge and CGST).
2. Union's grant-in-aids to the states.
3. How to augment State Govts' Consolidated funds to help their PRI/ULBs
4. Any other matters referred by the President of India such as:
 - ✓ Use Census-2011 for your calculation.
 - ✓ Keep in mind Union's responsibilities for New India 2022 vision.
 - ✓ Recommend measures for Fiscal discipline, Fiscal consolidation for the Union and State governments. Whether union government should continue to provide revenue deficit grants to States?
 - ✓ How to finance the disaster management initiatives?
 - ✓ Performance based incentives to the state governments?

17.5 15TH FC'S TOR: APPREHENSION OF THE STATES (राज्य आशंकावान क्यों हैं)

17.5.1 States Fear#1: New India 2022

- 15th FC is required to keep New India 2022 vision in mind (*wherein Modi government aims to double the farmers' income, provide housing for all, achieve 175GW of renewable energy etc.*).



- 15th FC also required to keep in mind Union's additional burden regarding defence, internal security, infrastructure, railways, climate change, commitments towards administration of UTs without legislature etc.
- So, TOR indirectly implying that 15th FC should give less than 42% to state governments because union government needs more ₹ for aforementioned activities. So, Non-BJP states are angry- "Tax evolution is our constitutional right".

17.5.2 States fear#2: Performance based incentives (प्रदर्शन आधारित प्रोत्साहन)

15th FC will recommend performance-based incentives based on (list not exhaustive)

Performance parameter	Why states apprehensive?
<i>State's Efforts in expansion of GST tax-net</i>	<ul style="list-style-type: none">➤ Manipur can't do as much as Maharashtra in deepening the GST tax net, owing to the variety of economic, geographic and political factors (frequent bandh and blockades).➤ Secondly, Constitution provides for a separate GST council with representatives of state governments. FC doesn't have state representatives.
<i>State's Efforts in achieving replacement level of population growth i.e. Total Fertility Rate 2.1 or lower</i>	Gangetic plain states' total fertility rate higher, so they're apprehensive that Kerala & other Southern States will get more money.
<i>State's Efforts in controlling the expenditure on populist measures (लोकलुभावन उपाय).</i>	Southern states have been running populist schemes for free TV, Fridge, Mixer, farmers' debt-waiver, Idli at ₹ 1 etc. Similarly Northern states run schemes for free bicycle, mobile & laptop schemes. They fear they'll be reviewed negatively, and union will get to keep more money for itself.
<i>State's Efforts in controlling power sector losses</i>	Electricity theft is a rampant problem in certain Gangetic states but their ruling parties turn blind eye because of electoral populism. Now they are apprehensive of getting less money.
<i>Behavioral changes to end open defecation.</i>	States resent that Modi's Swachh Bharat mission is 'imposed upon them'. FC devolution is their Constitutional right, and not an alm (खेरात) tied to their implementation of central schemes.

17.5.3 States fear#3: Census-2011 (जनगणना -2011)

- For horizontal distribution of taxes among states, 14th FC had used Census-1971 data. Census-1971 population was given 17% weight i.e. more populous state will get more funds.



- 15th FC's Terms of Reference (TOR) requires NK Singh to use ONLY Census-2011 data. But, Southern states have reduced their fertility rate between 1971 to 2011, whereas Northern states could not- due to poverty, illiteracy and lack of healthcare infrastructure. So, Southern states fear Northern states will get proportionately more funds, if Census-2011 is used.

17.5.4 States fear#4: Debt and Grants (ऋण और अनुदान)

- Article 293: States can't borrow without consent of the Union. So, what additional conditions should the Union impose on the states when they (states) borrow from market / external sources? TOR even requires 15th FC to make recommendations in this regard. States fear it'll reduce their autonomy in raising loans from the market.
- 15th FC will also examine whether to abolish revenue deficit grants be given to the States.

17.6 15TH FC: CONCLUSION निष्कर्ष

- ✓ SDG#10 reduce inequality within and among the countries. SDG#16 requires nations to build effective, accountable and inclusive institutions at all levels. An equitable distribution of revenue tied with performance incentives will help greatly in this regard. Therefore, we should wait till 15th FC's final report is released, before judging its adverse impact on states. OR
- ✓ States have limited avenues for collecting direct and indirect taxes. Hence, they are more dependent on the union devolution, and apprehensive of any reduction due to TOR. Union finance minister and 15th FC Chairman have already tried to allay states' fears through letters and meetings. Picture will become clear when final report is submitted latest by 30th October 2019. OR
- ✓ Economic Survey 2016-17 had observed 'aid-curse' in context of Redistributive Resource transfer (RRT) i.e. over the years, Special Category States received large amount of funds via Planning Commission and Finance Commissions yet couldn't perform well in poverty removal or economic growth due to lack of accountability and poor governance. The 15th FC TOR aims to link the fund transfers with performance and accountability parameters. While states are apprehensive, but such measures are the bitter pills that we'll have to swallow eventually to improve India's human development and economic growth.

Error in Answer Writing: Don't digress to unsolicited suggestions & overthinking like "Southern states should help Northern states in their family planning programs."



17.7 FC vs PC vs NITI: WHAT'S THE DIFFERENCE?

Finance Commission (FC) वित्त आयोग	Planning Commission (PC) योजना आयोग	NITI Aayog ----- -----
Constitutional body	Created by executive resolution, so neither constitutional non statutory. Both headed by ----- as the chairman.	
1951: 1st FC setup under KC Neogy	<ul style="list-style-type: none"> - 1951: PC set up and over the years designed 12 Five Year plans (12th FYP: 2012-2017) - 2014: Dissolved by Modi Government. 	<ul style="list-style-type: none"> - 2015: Formed. - Three Year Action Agenda (2017-20). - Seven Year Strategy Document. - Fifteen Year Vision Document(2017-32).
<ul style="list-style-type: none"> - Taxes' Vertical Devolution and horizontal distribution among states. - + any other matters referred by the President in TOR - Each finance commission arrived at its own methodology. E.g. 14th FC: 42% vertical, and 5 factor formula for horizontal distribution. 	<ol style="list-style-type: none"> 1. How much money should union give to each state for implementation of centrally sponsored schemes (CSS)? 2. How much money should union government give to the five year plans of the state governments? <p>To answer these Qs, PC would use ----- formula (designed in 8TH FYP)- based on population, per capita income, special problems etc. of a state.</p>	<p>It is not in its scope of work to decide how much money should be given to each state. That component is decided by the Finance Ministry.</p> <ul style="list-style-type: none"> - NITI's primary objective is to serve as the think tank of the Government of India, - Helps in policy design. - Helps in monitoring schemes' implementation through its dashboard e.g. 'School Education Quality Index (SEQI)', 'SDG India Index' and the 'Digital Transformation Index' (DTI).

We will see more about planning commission and Niti Aayog in Pillar 4

17.7.1 Special category states? विशेष श्रेणी के राज्य?

- **1952:** The National Development Council was set up, consisting of PM, CMs and other representatives to approve the five year plans prepared by the Planning Commission. But became obscure with establishment of NITI Ayog.
- **1969:** 5th Finance Commission recommended giving extra funds and tax-relief to certain disadvantaged states. Over the years, NDC added more states into the Special Category List based on (i) hilly and difficult terrain (ii) low population density and / or sizeable share of tribal population (iii) strategic location along borders with neighbouring countries (iv) economic and infrastructural backwardness and (v) non-viable nature of state finances.
- Examples: 8 North Eastern states and 3 Himalayan States (JK, Uttarakhand, HP).
- **Benefits of Sp.Cat. States?**
 - ✓ If Industrialists set factories in these states, they'll be given benefit in Union Taxes.



- ✓ In Centrally Sponsored Schemes, Union will bear higher burden (90:10).
- ✓ FC & PC would assign more weightage in their formulas to give'em more funds.
- **14th FC:** Previous Finance commissions would assign extra weightage & funds to Sp.Cat states, but 14th FC stopped this practice. But, whenever elections are near, W.Bengal, Bihar and Andhra CMs would demand Sp.Cat. status & blame Union for 'injustice'.
- **Economic survey 2016-17:** आर्थिक सर्वेक्षण Noted that Sp.Cat states have received lot of funds & grant from previous FCs and PCs, and yet they have not made any tangible progress in improving public administration or removing poverty (= "Aid Curse": सहायता का अभिशाप). Similar problem with States having abundant mineral resources ("Resource Curse": संसाधनों का अभिशाप).
- **Economic Survey 2017-18:** Noted that compared to Brazil, Germany and other countries with federal polity, India's state governments and local bodies are collecting less amount of tax for two reasons
 - (1) constitution has not given them sufficient taxation powers
 - (2) even where constitution gave them powers like collection of Agricultural Income Tax, Land Revenue, Property Tax- they are shy of collecting taxes for electoral politics. Hence States/PRI/ULBs unable to deliver public services satisfactorily e.g. Public Schools, Public Transport, Police, Drinking Water and Sanitation.

18 TAXATION → BLACK MONEY & ALLIED ISSUES

Tax Planning / Tax Mitigation कर-नियोजन	When person invests money in LIC/PPF/Pension funds etc. in such manner that he can claim various deductions available in the Income Tax Act. It's neither illegal nor unethical.
Black Money (काला धन)	----- (=concealed from the tax authority.).
Parallel Economy	The economy that runs on black money. (समानांतर अर्थव्यवस्था)
Tax Evasion कर अपवंचन	When person hides income or transaction from tax authorities, and thereby evades paying taxes. It's illegal.
Tax Avoidance कर परिहार	When person discloses his income and transactions to tax authorities but uses legal loopholes to avoid paying taxes. E.g. Bollywood stars who register digital media companies in Tax Havens. It may not be illegal in every case, but still unethical.
Tax Haven कर स्वर्ग	Is a country that demands little taxes from foreigners and offers legal loopholes for Tax Avoidance & opportunities for Tax Evasion. E.g. <i>Liechtenstein, Mauritius, Marshall Islands, Cayman Islands, Panama, Nauru, Vanuatu etc.</i> These countries are geographically small, & without viable



	economy. So they offer such mechanism to attract foreign investors and foreign tourists.
Money laundering (गैरकानूनी तरीके से प्राप्त धन को वैध बनाना / धनशोधन करना)	<ul style="list-style-type: none"> - When drug trafficking, ransom, corruption and other criminal activity generates substantial profits, the person has find ways to spend / invest / hide the money without attracting attention. - Money laundering is the process of disguising the source of money, as if it came from a legitimate activity, & then channelize it into banks, share market and other financial intermediaries.
Shell firms Post-box Letter-box companies	They do not have any active business operations, and are created with the sole objective of money laundering and tax evasion. E.g. Ms Mishail Packers and Printers Pvt Ltd. setup by Misa Bharti Yadav to launder ₹1.2 crores (as per Enforcement Directorate).
Panama Papers (2016) Paradis Papers (2017)	German Journalists released these incriminating documents from certain law firms in tax havens & showed how notable people across the world engaged in tax avoidance/ evasion. Bachchan & Aishwarya also named in them.
Tax Terrorism कर आतंकवाद	<p>Happens when tax authorities put undue pressure on an honest taxpayer to pay more taxes.</p> <p>2012: Vodafone won a case against income tax department in the supreme court related to Capital Gains Tax on purchase of Hutch mobile company.</p> <p>Afterwards, UPA government amended the income tax act with retrospective effect and issued fresh notices against Vodafone. So, Modi called it “UPA’s Tax Terrorism on Corporates”</p>
TDS/TCS	<p>Tax Deduction at Source (TDS) स्रोत पर कर कटौती</p> <p>Tax Collection at Source (TCS) स्रोत पर कर संग्रह</p> <p>These are the mechanism to discourage tax evasion.</p>
PAN Card स्थाई खाता संख्याक	12 letters alphanumeric numbered assigned to all taxpayers in India by Income Tax Dept. <i>Refer to GST Handout for more.</i>

18.1 BLACK MONEY → NOTABLE ORGANISATIONS

Enforcement Directorate (ED: प्रवर्तन निदेशालय)	<p>FinMin → Department of Revenue → ED is a Specialized financial investigation agency to enforce following laws</p> <ol style="list-style-type: none"> 1. Foreign Exchange Management Act, 1999 (FEMA) 2. Prevention of Money Laundering Act, 2002 (PMLA)
Directorate of Revenue Intelligence	<p>FinMin → Department of Revenue → CBIC → DRI is an agency against Customs/Narcotics/Wildlife/Arms related smuggling & illegal activities. (DRI: राजस्व आसूचना निदेशालय)</p>



Financial Intelligence unit (FIU-2004: वित्तीय आसूचना एकक)	It analyses the suspected financial transactions in domestic and crossborder levels & reports directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.
Financial Action Task Force (FATF-1989: वित्तीय कार्रवाई कार्यदल)	is a brainchild of G7, Combating Money laundering and terror finance. HQ@Paris. India became member in 2010.
OECD (1961:आर्थिक सहयोग तथा विकास संगठन)	----- HQ@Paris. Works for International cooperation in the matters of economy and taxation. Known for Base erosion and profit shifting (BEPS) Norms. India is a member.

18.2 TAXATION → TAX EVASION (HIDING INCOME / TRANSACTION)

18.2.1 ----- (PMLA-2002)

धनशोधन निवारण अधिनियम

- 1998: UNGA declaration on Money Laundering. 2002 India enacts this law to combat money laundering, search-seizure-arrest-penalty. **Main agency?** Enforcement directorate.
- Cases are heard @ PMLA Adjudicating Authority (न्यायनिर्णयन प्राधिकारी) → PMLA Appellate Tribunal (अपीलीय प्राधिकरण).
- It also empowers the RBI, SEBI, IRDAI and other regulator to make norms for Banks/NBFCs & punish the errant parties.
- E.g. RBI's Know Your Customer (KYC) norms and Anti-Money Laundering (AML) standards. Online Magazine Cobrapost conducted sting operation on ICICI Bank, HDFC Bank and Axis Bank & RBI Imposed a heavy penalties (2013).

18.2.2 ----- (UFIA-2015)

अज्ञात विदेशी आय तथा परिसंपत्ति अधिनियम

- It requires Indian residents to disclose their foreign assets (e.g. bungalow in Dubai, Bank account in Switzerland) and income coming from foreign sources (e.g. shell company in Cayman Island) in their income tax returns.
- Foreign source income will be subjected to 30% income tax. No deduction, exemption or rebate will be given on it.
- **Violation** = Penalty + upto 10 years jail time. If a company is found violating the Act, then every person responsible to the company shall also be liable for punishment unless he proves that it was done without his knowledge.
- It also empowers the Union to enter into agreements with other countries for the tax exchange of information.

18.2.3 ----- (BTPA- 1988, 2016)

- बेनामी लेनदेन (निषेध) अधिनियम: Original act in 1988 but did not achieve much results → amended in 2016. **Main Agency?** Income Tax Department.
- Benami refers to properties that buyer registers in the name of his relative, personal staff (driver, gardner) or a non-existent/ fictitious persons to avoid tax authorities'



attention. E.g. 2018: Misa Bharti Yadav (allegedly) bought farmhouse in the name of her brother-in-law Nilesh Kumar.

- Cases are heard @ PMLA Tribunal → PMLA Appellate Tribunal.
- **Violation** = Confiscation of property + penalty + upto 10 years jail time.

MCQ. With reference to the 'Prohibition of Benami Transactions Act', find correct statement(s): (Asked in UPSC-Pre-2017)

1. A property transaction is not treated as a benami transaction if the owner of the property is not aware of the transaction.
2. Properties held benami are liable for confiscation by the Government.
3. The Act provides for three authorities for investigations but does not provide for any appellate mechanism.

Answer Codes: (a) 1 only (b) 2 only (c) 1 and 3 only (d) 2 and 3 only

18.2.4 Tax (Evasion) Amnesty schemes

Under such schemes, a tax-evader can declare his undisclosed income, pay the taxes and penalty. Then, Income Tax Department will not pursue case against him. (Although Police may still pursue case if income is related to narcotics, kidnapping, extortion etc.)

<i>Income Declaration Scheme (IDS)</i>	Offer? 45% of the undisclosed income shall be taken away by govt as (tax 30%+ surcharge 7.5% + penalty 7.5%). Validity? 2016 June to Sept. ~67,000 cr black money was declared.
<i>Pradhan Mantri Garib Kalyan Yojana (PMGKY) Launched after Demonetization</i> Validity? 2016-Dec: To 2017-April	<ul style="list-style-type: none"> - ~50% of the undisclosed income shall be taken away by Govt. as Tax + Penalty + Pradhan Mantri Garib Kalyan Cess. - The PM Garib Kalyan cess, and deposit will be used for schemes related to irrigation, housing, toilets, infrastructure, edu, health etc. - Further, 25% of the undisclosed income shall be deposited in RBI's 'Pradhan Mantri Garib Kalyan Deposit Scheme, 2016'. It'll be a fixed deposit for 4 years @ ZERO % Interest - The scheme was not so successful, hardly ~5000 cr. declared.

18.2.5 Tax Evasion → Other Initiatives

Banking Cash Transaction Tax (BCTT: 2005-09)	A 0.1% direct tax levied on cash withdrawals from banks. Started by Chidambaram but later withdrawn (2005-09). Objective was to encourage less-cash economy and data mining of transactions.
(Suggested) Banking Transaction Tax (BTT)	A proposal given by a Pune based think-tank to Baba Ramdev that all the direct and indirect taxes of the Union and the states should be abolished and replaced with 2% tax on banking transactions. Impracticable because such experiments were tried and failed in Australia and other countries as people shifted to using barter system, diamonds and gold for transaction. 2017: Govt clarified they are not considering any such proposal.
SC's SIT on Black Money 2014	Chairman: Retd. SC Justice MB Shah, and senior tax officials. They recommended various measures against Black Money hidden in India, in overseas banks, P-Notes etc. SC ordered Govt to implement this report.



Operation Clean Money 2017	Income Tax Dept. verified large bank deposits made in the aftermath of demonetisation. Phase 1- Jan 2017, Phase 2 - April 2017.
Project Insight 2017	Income Tax Dept. hired L&T Infotech Ltd to develop an integrated platform for data mining & tracking tax evaders. (Related) Project Saksham 2016: CBEC/CBIC's project for digital re-engineering related to GST. It's not a 'drive against black money' but for 'Ease of Paying Taxes'. <i>More in GSTN handout.</i> (Related) Aaykar Setu: CBDT's mobile app to pay Income Tax.
Restrictions on Cash Transactions, 2017	Budget 2017 → Finance Act, 2017 → if anyone accepts ₹ 2 lakh /> CASH in a day / in multiple transactions related to one 'event', then Income Tax Dept penalty = 100% of the cash received. Banks, post office, government organisations are exempted.
Electoral Bonds, 2017	Ref: SEBI/Sharemarket handout & write the gist in margin.

18.3 TAXATION → TAX AVOIDANCE (कर परिहार / कर टालना)

Here, people will not hide the transaction, they'll blatantly declare it in their balance sheets but use legal loopholes to avoid paying taxes.

18.3.1 Angel Tax on Startup Investments (2012)

- Angel investors are the rich people who occasionally invest equity-capital in startup companies out of hobby / timepass / profit motive. (Whereas Venture Capital Companies do the same thing but on regular & serious basis)
- Startup Entrepreneur Sunder Yadav registers a phoney "Sunder Construction" as an (unlisted) Public Limited Company with ₹ 10 Face Value Shares, & sells them to Angel Investor Sadhu Yadav @a premium price of ₹ 1,000 per share.
- But, even construction sector's (listed) public limited companies like DLF's shares are going around for ₹ 230, then Sunder-startup's shares are above 'fair market price'. So, this is not a genuine "Angel investment" but rather a facade for laundering Sadhu Yadav's money from construction, corruption or extortion business.
- So, UPA/Congress's Budget-2012 required Sunder Construction (the Startup Company) to pay 30%Tax + Penalty on the investment they received from Angel investor Sadhu Yadav. This is dubbed as 'Angel Tax'.
- Norms were further tightened by Modi-regime, but then controversy that it will discourage the growth of startup companies so norms relaxed- '*Angel Tax will not apply if Startup's turnover is less than ₹ "x" crores or if startup was registered for upto "y" years.*'

18.3.2 _____ (DTAA) & Round Tripping

दोहरा कराधान परिहार समझौता

- It is a tax treaty signed between two or more countries.
- **Objective?** A taxpayer resides in one country and earns income in another, then he need not pay tax twice in two countries for the same income.
- e.g. India Mauritius DTAA (1982): If a Mauritius person / company buy shares in India and sells them at profit, then he need not pay capital gains tax (CGT) in India. Only the Mauritius government can ask CGT from him.



- **Loophole?** India has ~10-20% CGT whereas Mauritius has ~0-3% CGT (depending on nature of asset, how long the buyer kept asset before selling etc). So many Indian Politicians, Businessmen and Bollywood actors would transfer the money to shell companies in Mauritius, and then make those Mauritius shell companies to invest back in Indian assets & avoid paying Indian CGT. This process is called **Round Tripping (राउंड-ट्रिपिंग)** i.e. money that leaves the country through various channels and makes its way back into the country as foreign investment.
- Similar loophole in India Singapore DTAA.
- **2016:** Modi government amended the treaties so that even Mauritius and Singapore investments in India will be subjected to Indian taxes**.

18.3.3 ----- (POEM: पीओईएम)

- Bollywood Producer “A” forms a shell company in Cayman Islands (because it has very low corporation tax). He gives this company international movie distribution rights for his Indian movie @₹ 10 only. Then, Cayman Island company makes ₹ 50 crore profits, but he'd not pay any taxes in India saying its a foreign company making profits from foreign territories, so Income tax department has no jurisdiction!
- But, here the place of effective management is India, from where the Bollywood producer would be really taking the decisions of this shell company.
- So, **Budget-2015** introduced the concept of POEM. Such overseas / foreign company will be subjected to India's 40% Corporation tax + cess + surcharge.

18.3.4 ----- (BEPS: बीईपीएस)

- Multinational company (MNC) “M” opens fast food outlets in India & makes ₹ 50 crores profit. By default, it should be subjected to 40% Corporation tax in India.
- But then MNC shows its Indian outlets had taken loan / raw material / patented technology from MNC's shell firm in Bahamas (where Corporation tax is 0-2%). So, after deducting these operating costs, it has zero profit, so in India, it will pay only 18.5% Minimum alternative Tax (MAT), instead of 40% Corporation tax.
- Thus, when MNCs shift profit from its source country to a tax haven to avoid / reduce paying taxes, its known as “BEPS”. OECD & G20 have made a Framework to tackle this nuisance.

18.3.5 Transfer Pricing (हस्तांतरण मूल्य)

- Transfer pricing happens whenever two subsidiary companies that are part of the same multinational group, trade with each other.
- Suppose Coca Cola (Indian Subsidiary) buys Sosyo Company's shares or soda formula at ₹ 10 crores, and then sells it to Coca Cola (Cayman Islands) at ₹ 10 rupees. Then ₹ 10 is the transfer price.
- Coca Cola (Cayman Islands) further sells Sosyo's shares / Soda-Formula to other companies at very high price. Yet, Indian tax authorities will not get any Capital Gains Tax (CGT) even though Coca-Cola (USA holding company) may be making profit (Capital Gains) of billion\$ from this 'Indian Asset' (Sosyo).
- 2001: Transfer pricing related provisions were added in the Income Tax Act. but they were quite strict leading to 'tax terrorism' by IT officials who'd slap notices on every transaction, resulting into 'No ease' of doing business for MNCs.



18.3.6 Authority for Advance Rulings (AAR)

- After above episode, Pepsy (India) would like to know in advance whether its transfer price of ₹ “y” or its imported / exported item worth ₹ “z” is agreeable to tax authorities or not? lest it suffers from notices, raids and litigations afterwards.
- For this purpose, Authority for Advance Rulings (and their Appellate bodies) have been set up under the income tax act, Customs act and even GST Act (recall Amul Camel Milk).
- Advance pricing agreement (APA: अग्रिम मूल्य निर्धारण समझौता)= If in previous example, Coca Coal approached AAR and an agreement was signed between taxpayer and a tax authority that “*Transfer price of ₹ y is agreeable to both of us, and will not attract any notices / raids / litigations afterwards.*”

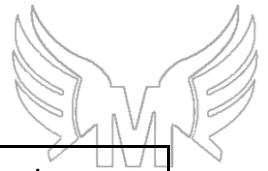
18.3.7 _____(GAAR: कर परिवर्जन रोधी व्यापक नियम)

- So far in various examples we learned how Indian and foreigners avoid tax payment in India through loopholes like DTAA, POEM, BEPS, Transfer Pricing etc.
- So, UPA/Congress Govt setup economist Parthasarathi Shome panel who suggested General Anti Avoidance Rules (GAAR) → they were incorporated in Income Tax Act in 2012.
- GAAR empowers Income Tax officials to send notices to both Indians and foreigners for suspected tax avoidance. (For Tax evasion, we’ve separate laws- PMLA, UFIA, BTPA)
- But critics alleged GAAR will result in tax terrorism and harassment of individuals. So successive Budgets kept delaying the GAAR- implementation. Finally done on 1/4/2017.

18.3.7.1 Reforms to reduce Tax Terrorism / Harassment

- In the previous section we learned about the “Tax evasion”, and notable measure → laws, ban on cash transaction of ₹ 2 lakh / >, Operation Clean Money etc. So on one hand, income tax department has to become strict / coercive like that to fight against Tax evasion.
- At the same time, IT dept. also needs to become more friendly towards honest taxpayers, while reducing the scope of tax avoidance. Here notable measures are →

Rajaswa Gyan Sangam 2016 & 2017	Organised by CBDT & CBIC for idea exchange between policy makers and senior tax officers. 2016: Modi gave them RAPID Mantra: R for Revenue, A for Accountability, P for Probity, I for Information and D for Digitization.
Direct Tax Code 2010	This bill aimed to replace the Income Tax Act, 1961 with simpler provisions. But, lapsed with 15th Lok Sabha dissolution in 2014.
Easwar Panel on Direct Taxes 2015	To simplify the provisions of IT Act, 1961, to remove ambiguities that cause unnecessary litigations & hardships to Tax payers.
Arbind Modi Taskforce 2017	Setup by CBDT to draft New Direct Tax Legislation (Law) to replace IT Act 1961. Later Arbind modi retired & replaced by Akhilesh Ranjan. 2019-Feb: Panel sought 3 months extension ke report not yet prepared.



-----	2017: CBDT's mobile app that helps you calculate and pay Income Tax, claim TDS refunds etc.
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18.3.8 Global Treaties, Agreements & Indexes

18.3.8.1 Tax Information Exchange Agreement (TIEA: कर सूचना विनिमय समझौता)

- India has signed such agreements with multiple countries. It enables mutual sharing of information to detect tax avoidance and tax evasion.
- On Indian side, CBDT is the the nodal agency for such agreements.

18.3.8.2 USA's Foreign Account Tax Compliance Act (FATCA-2010)

विदेशी खाता कर अनुपालन अधिनियम

- USA's FATCA Act requires foreign financial Institutions (such as Indian Banks, Pakistani Insurance Companies, Chinese Mutual Funds etc) to report the assets held by Americans.
- This helps US Tax authorities to detect tax avoidance / evasion by Americans who are hiding income outside USA.

18.3.8.3 Global Financial Secrecy Index (वैश्विक वित्तीय गोपनीयता सूचकांक)

- Prepared by London based Think Tank 'Tax Justice Network (TJN)'.
- It uses 20 indicators to measure the countries on their financial secrecy, opportunities for Tax Avoidance, BEPS etc.
- 2018 Ranking: ----- (1st), India (32),

18.4 BLACK MONEY → DEMONETISATION (विमुद्रीकरण)

- **Definition?** Demonetization is the wholesale withdrawal of currency notes from circulation.
- RBI Act 1934: Every banknote is a legal tender. However, RBI Central Board can recommend the Government of India to notify specific currency note(s) should no longer be treated as legal tenders. Then FinMin → Department of Economic Affairs makes official gazette notification.
- 1946: ₹ 500 Notes demonetized; 1978: ₹ 1000, ₹ 5000, ₹10000 Notes demonetized.
- **2016-Nov-8th:** Public was ordered to deposit the (old) Mahatma Gandhi series currency notes ₹ 500 and ₹ 1,000 (henceforth called "Specified Bank Notes (SBN)") into Banks and post-offices latest by 30th December 2016. And all the banks and post offices where order to deposit such SBN into RBI.
- **Specified Bank Notes (Cessation of Liabilities) Ordinance:** From 31st December 2016, RBI Governor not required to honor "I promise to pay..." or exchange the SBN. Except for NRIs, deadline little bit relaxed, with certain norms. Public prohibited from keeping SBN, except for research or numismatics or museum- and that too in limited amount. This ordinance became Act in 2017.
- India is not the only country in the world to do demonetisation. Sweden (2013), European Union (2016) and even Pakistan (2015) has done it for their currency notes.

18.4.1 Why Demonetise ₹ 500 & 1000?

- Demonetization is usually done in the aftermath of hyperinflation, war & regime-change.
- India did it to combat ----- .



- We had 12.04% Cash to GDP ratio, one of the highest in the world. Currency printing & transportation cost alone was 1.7% of GDP.
- "Soil rate" is the rate at which notes are considered to be too damaged to use and returned to the RBI. For ₹ 500 & 1000 SBN-notes, soil rate was much lower than the currency notes of ₹ 10 to 100. (implying that 500-1000 SBN were used more for 'storing black money', rather than using in transactions.)
- So, experts made mathematical comparison of the foreign countries' economic development, soil rates of their foreign currency notes etc. and arrived at a figure ₹ 3 lakh crores of Indian black money is stored in SBN (=2% of GDP).
- So if SBN were demonetised, the black money holders will not return their currency notes into banks (fearing IT-RAIDS) and thus black money will be destroyed.
- But in reality, 99.30% of the SBN were returned back into the banking system, so hardly ₹ 10,720 crore of black money was destroyed by the demonetisation of 2016.

18.4.2 How did 99.30% SBN returned into banking system?

If the mathematical modelling was correct, then only 80% of the SBN should have returned back, & 20% SBN (presumed to be Black Money) should not have returned. But, Black money owners used following tricks to deposit their SBN in bank accounts:

1. Businessmen / Politicians used their drivers, cooks, gardeners, personal staff members and relatives as Money mules. This is evident from exponential rise in the deposits in Pradhan Mantri Jan Dhan bank accounts.
2. SBN were given out as "loans" to poor & as advance salaries to workers.
3. Agents who tied up with corrupt bankers who exchanged SBN without KYC verification.
4. SBN deposited in Cooperative Banks as back-dated Fixed Deposits (Because Cooperative Banks didn't use Core Bank Solution so it was possible to temper records)
5. Similarly, SBN deposited in banks and then shown as income from sale of (fictitious) grain stock etc. So, IT-dept can't demand tax on it (and most state governments not levy tax on agricultural income due to vote bank politics).
6. SBN deposited in shell companies & shown as income from (fictitious) sale and invoices.
7. SBN donated to trust, temples & Political Parties with backdated receipts (and those entities are exempted from Income Tax on their income.).... And so on

18.4.3 Even if 99.30% SBN returned, it's not failed experiment because:

- ✓ Those who could not return their SBN, have lost their black money (₹ 10,720 crore)
- ✓ Those who used poor people as money mules- must have paid some commission to them. So even if government did not get tax from black money, at least poor people benefited.
- ✓ Further, during Operation Clean money, IT-dept issued notices to the suspicious bank accounts where large amount of money was deposited. Such shell firms & their benami properties are being seized.
- ✓ With Project Insight & Op. Clean Money: IT dept fetched ₹ 1.30 lakh crore in taxes and penalty, attached ₹ 7000 crore worth Benami properties, ₹ 1600 crore worth foreign assets & de-registered ~3.40 lakh shell firms. (*Figures from Int-Budget-2019*).
- ✓ The number of PAN card registration, IT returns, registrations under excise / VAT / GST have greatly increased in the aftermath of demonetisation which proves that crooked



people have learned lesson. More than 1 crore new income tax assesses are added in 2017.

✓ Tax collection has increased from ₹ 6 lakh crores (2013) to ₹ 12 lakh crores (2018).

18.4.4 Demonetization: short term challenge, long term benefit (Eco. survey 2016-17)

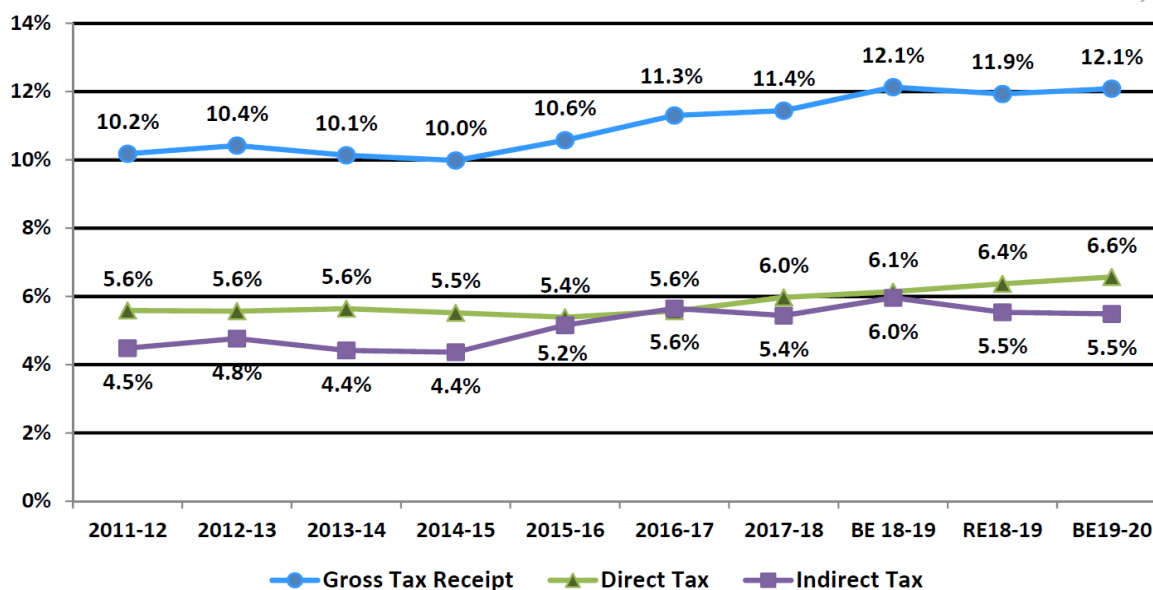
Area	Short term challenges	long term benefits
Banking	Administrative challenges on the bankers to exchange the banned notes	Growth in the deposits → more loans can be given @cheaper interest rate, Less Cash economy & associated benefits.
Real Estate	Sale of houses declined	Prices & rents of houses should decline. Migrants will benefit.
Economy at large	Job loss in cash-intensive sectors like diamond polishing, farm laborer, MSME	Less-cash economy, digitization and formalization of economy, Bizmen getting GST registrations → further surveillance → forced to show their employees on paper → EPFO & ESIC benefits to worker.
Growth rate	Slow down	improvement

SELF-Study for Mains: Economic survey 2016-17 Vol1ch3, table 2 “impact of dem” .

18.5 ECONOMIC SURVEY ON TAXATION AND FISCAL CAPACITY (वित्तीय क्षमता)

The last three economic service have repeatedly observed that

- Democracy is a contract and taxation is the economic glue that binds government and citizens into this contract.
- But, when ever government delivers poor quality of service in public schools, hospital etc. → middle class and rich citizens will “EXIT” towards the private school and hospitals → Then they also feel ‘moral right’ to evade / avoid taxes, because they are no longer using public services. **Result?** hardly _____ are taxpayers (23% is desirable, as per our level of development against BRICS nations.)
- Govt gets less taxes → poor fiscal capacity → poor services → vicious cycle continues and results in decline of govt’s accountability towards citizens.



18.5.1 The reasons for low Tax: GDP in India:

- Lack of civic sense among people that paying taxes is their basic duty.
- Presence of informal sector, parallel economy, cash based economy.
- Low per capita income, high level of poverty.
- Concentration of income in the hands of few- who are greedy to engage in tax evasion & avoidance.
- Election funding as the mother source of corruption, and therefore black money. Politician-Builders-Mafia nexus.
- Due to political considerations, state governments and local bodies do not levy all the taxes authorised by the constitution e.g. tax on agricultural income. So our (direct) tax base is narrow. [Tax base: कराधार means the the total value of all the income, property, etc. on which tax is charged.]
- Loopholes in the tax laws which encourage tax avoidance using Domestic and Offshore channels.
- Direct taxes like wealth tax, gift tax and estate duty suffered from loopholes, lax monitoring and evasion, they didn't yield much revenue. Hence even referred as '**paper taxes**'.

18.6 TAXATION: MISC. TERMS

Laffer Curve (लफ़र वक्र):	<ul style="list-style-type: none"> - American economist Arthur Laffer: if tax rates are increased above a certain level, then tax revenue collection will fall because higher tax rates discourage people from working (and/or engage in tax evasion and tax avoidance). - So, tax-cuts could lead to higher tax revenue collections. - Budget-2017: The lowest Income Tax slab was cut from 10% to 5%; The corporation tax on small sized companies was also brought down from 30 % to 25% - USA Budget-2017: Corporation tax cut down from 35 % to 15%
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Tax buoyancy (कर उत्प्लावकता):	<ul style="list-style-type: none"> - Measures the comparative growth in tax collection against the growth in national output or national income. - E.g. if income tax collection growth rate is 11% when GDP growth rate is 10%, then its tax buoyancy is 1.1
Tax elasticity (कर लचिलाता):	If first income tax slab increased from 5% to 15% then in absolute terms how much more IT-revenue will be generated?

18.6.1 Net Tax Revenue of the Govt (शुद्ध कर राजस्व)

Sr.	Budget → Revenue Receipts → Tax Receipts	Expected in 2019-20
A	Union's Direct taxes, incl. cess and surcharge	~ _____ lakh crores
B	Union's Indirect taxes incl. cess and surcharge. <ul style="list-style-type: none"> - For Union: direct taxes income is >> indirect taxes. - But if we summed all taxes of union, state and local bodies then indirect taxes income >> direct taxes. 	~ _____ lakh crores
C	Union territories without legislature: their direct and indirect taxes: विधानमंडल रहित संघ राज्य क्षेत्र	~6000 crores
D	Gross Tax Revenue (=A+B+C) सकल कर राजस्व	~26 lakh crores
E	Minus the Tax devolution to States (कर हस्तांतरण) as per GST council (for CGST) and Finance Commission (for non-CGST taxes).	(-)~8.5 lakh crores
F	Minus Contributions to National Disaster Response Fund in Home ministry*	(-)~2500 crores
<u>D-E-F</u>	Net Tax Revenue of Union (शुद्ध कर राजस्व)	~ _____ lakh crores

*National Disaster Response Fund (राष्ट्रीय आपदा प्रतिक्रिया कोष) is a statutory fund under Disaster Management Act, 2005. Previously, called National Calamity Contingency Fund (NCCF).

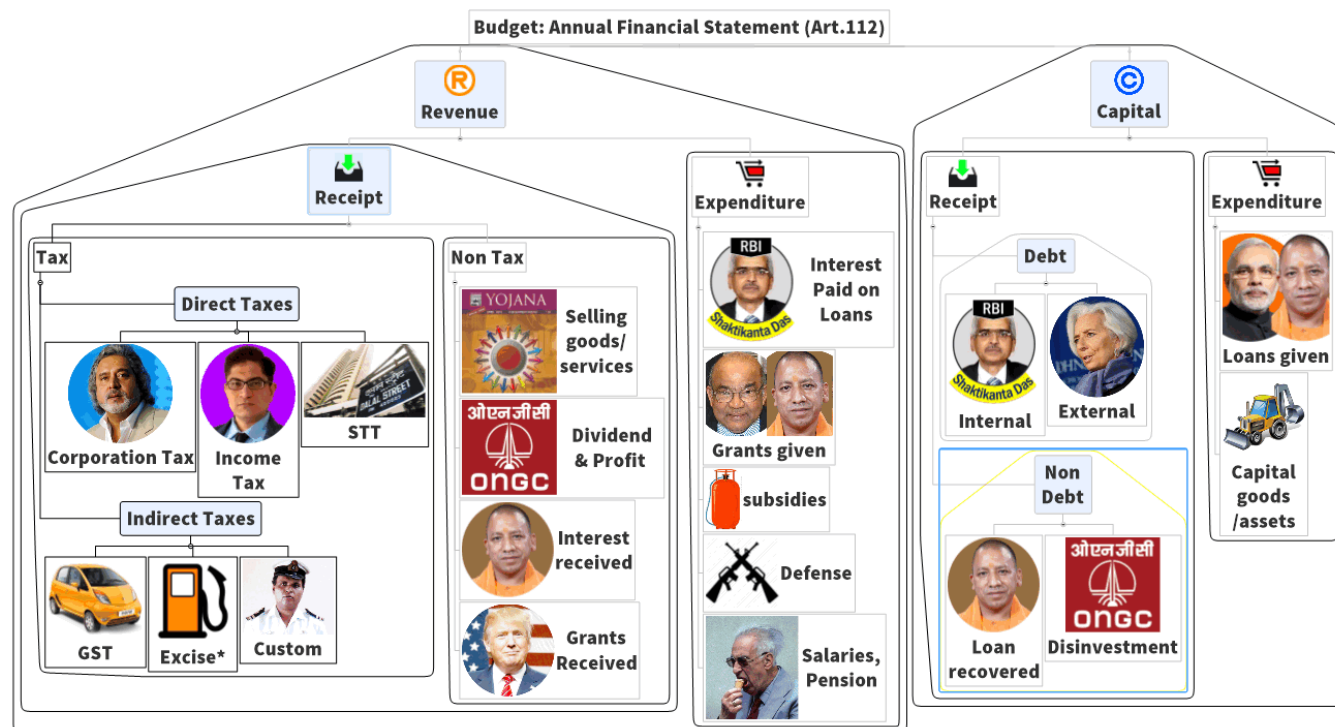


18.6.2 Revenue Shortfall (राजस्व में कमी)

Type of Tax	Tax in ₹ crores	2018-19 Advance Estimates Made in Feb-2018	2018-19 Revised Estimates in Feb-2019	2019-20 Advance Estimates Made in Feb-2019
Direct-Tax	Corporation Tax	621000	671000	760000
Direct-Tax	Income Tax	529000	529000	620000
Direct-Tax	STT	11000	11000	12800
Indirect Tax	Custom Duty	112500	130038	145388
Indirect Tax	Excise on Fuel, Alcohol**	259600	259612.2	259600
Indirect Tax	GST	743900	643900	761200
Gross Tax Revenue →		22.7 lakh crores	22.4 lakh crores	26 lakh crores

- 1/2/2018: Budget 2018 is presented for the next financial year starting from 1st April 2018 to 31st March 2019. So, FinMin could have only made projections /estimations about how much taxes will be collected during 1/4/18 to 31/3/19.
- But throughout the year, based on the advance tax-collection figures & monthly GST collection figures, FinMin will have to re-adjust the estimates.
- 1/2/2019: (Interim) Budget 2019 is presented, along with that, Govt will present revised estimates for previous Financial Year (2018-19).
- From the table we can see that Gross Tax collection is less than expected (22.7 MINUS 22.4) = ~30,000 crores is 'Revenue Shortfall', mainly because _____ were less than expected.

18.7 BUDGET → REVENUE PART → RECEIPTS → NON-TAX RECEIPTS





Notable sources of Non-Tax revenue (In descending order)	2019-20
<ul style="list-style-type: none"> ✓ Interest receipts (ब्याज प्राप्ति) received on Union's loans to states, railways, CPSE, foreign countries.) is a revenue receipt. [Had those borrowers repaid loan-principal, then that portion is 'Capital Receipt'] ✓ Dividends and profits received from CPSE, PSBs, RBI. [Had Union sold its shares to a third party (disinvestment / privatization), then that will be 'Capital Receipt']. <p>Union's income from (Dividend & Profits) >> from Interests.</p>	1.5 lakh cr.
Income from selling various goods & services such as railways, postal services, selling of India Yearbook-, Yojana-Kurukshetra magazines, fees that CISF charges for giving protection to Private Airports, auction of spectrum & mining rights, selling of commemorative coins etc.	1.2 lakh cr.
Grant in Aid (अनुदान)/ Donations received by Union. [Had Union received 'loan', it'll be 'Capital Receipt']	1000 cr.
Similar Non-tax revenue earned by UT without Legislature	2000 cr.
Sum of Above= Total Non-Tax Revenue Receipts कर-भिन्न प्राप्ति	~2.7 lakh cr.

Total Revenue Receipts= NET Tax receipts (~17.0 lcr) + Non-Tax receipts (~2.7 lcr)= ~20lcr.

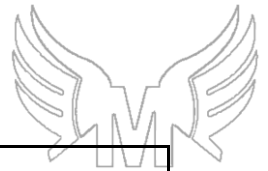
Figures are not important, but the fact that revenue budget: the tax receipts >> non-tax

19 BUDGET → REVENUE PART → REVENUE EXPENDITURE

बजट → राजस्व भाग → राजस्व व्यय: Revenue-expenditure are usually associated with

- Expenditures spent on day to day functioning of the organs of the state = salaries & pensions, stationery, electricity bill, phone bill etc. in Executive, Judiciary, Legislature; Various Constitutional & Statutory bodies.
- Expenditures that do not create income generating assets or permanent assets or financial assets. So, money SPENT on loan-interests, subsidies, scholarships, grants etc. are Revenue Expenditure.

Notable Revenue Expenditures (In descending order)	2019-20
Interest to be paid on previous loans is Revenue Expenditure. [Whereas Union repays loan-principal, its 'Capital Expenditure']	— — — — lakh cr.
<ul style="list-style-type: none"> - Grant-in-Aid (अनुदान) to States & Local Bodies for Disaster Management, Panchayati Raj Development etc. as per Finance Commission recommendations. Additionally, Govt also gives grants to foreign countries for its soft-diplomacy. 	4.7 lakh cr.



- Grant = Amt doesn't have to be returned with Interest. (Whereas If Govt gave 'loans' to States/CPSE/Foreign Countries then it's an income generating financial asset = counted under Capital Expenditure).	
Subsidies. Within them descending order 1. Food subsidies: ₹ 1.8 lakh cr. 2. Fertilizer (Urea > Others): ₹ 75,000 cr 3. Fuel (LPG > Kerosene): ₹ 37,000 cr 4. Interest Subsidies on loans: Farmers (highest), MSME, Affordable Housing, LIC Vay Vandana Yojana etc.: 25,000 cr. 5. Other Subsidies (Haj Subsidy etc): 12000 cr.	_____ lakh cr
Defense related revenue expenditure (e.g. soldier salaries, fuel for tanks)	2 lakh cr
Pension to retired employees (In the last 3 years it has kept rising.)	1.9 lakh cr
<ul style="list-style-type: none"> ➤ Economic services related revenue expenditure (Agriculture, energy, transport, communication, Science technology) ➤ Social services related revenue expenditure (health, education, social security): ➤ Expenditure on Administrative machinery (Police, Jail, External Affairs etc.), Elections, Parliament, Judiciary: ➤ Revenue expenditures of UT without Legislature: 	Fig. not imp.
Total Revenue Expenditure कुल राजस्व व्यय	~25 lakh cr
Total Revenue Receipts (Tax + Non Tax Receipts) कुल राजस्व प्राप्तियां	~20 lakh cr
Revenue Deficit = Revenue Receipt MINUS Expenditure. *If we used precise figures instead of (~)approximation, then its ₹ 4.7lcr.	~5 lakh cr*
Projected GDP for 2019-20 is ₹ 210 lakh crores. So Revenue Deficit as a percentage of GDP = (4.7 lakh crore /210 lakh crore)*100. =	_____ %

19.1 REVENUE EXPENDITURE → SUBSIDIES

Tax (₹ ~26 lakh crores in Int-buget-19)	Subsidies (₹ ~ __ lakh cr in Int-buget-19)
Tax is a compulsory contribution imposed by State. Refusal to pay the tax is punishable.	A subsidy is a benefit given to an individual or firm by the government to reduce some type of burden. A person may refuse to accept the subsidy, He will not be punished for it.
Tax doesn't promise specific and direct goods/services to the taxpayer. (Mukesh Ambani will still be subjected to potholes)	A specific benefit is promised e.g. 6000 to farmers, idlis @₹ 1 rupee in Amma Canteen (Tamilnadu).



19.1.1 Types of subsidies with selected examples

1. **Given in direct cash (or bank transfer):** PM KISSAN 6k, LPG Pahal ~200 per cylinder.
नगद में दी जाने वाली सब्सिडी
2. **Given in kind:** free school bags, uniform and books to the poor children, free medicines in public hospitals, free insurance. मुफ्त वस्तु या सेवा के रूप में दी जाने वाली सब्सिडी
3. **Indirect (परोक्ष) subsidies:** cheap fees in government colleges, cheap kerosene, cheap urea, cheap crop insurance premium etc. Here govt. is paying some money to an organization so that they may provide goods/services @cheaprte to the beneficiary.
4. **Regulatory (नियामक) subsidies:** e.g. if State Electricity Regulatory Commission directs companies that electricity to farmers must NOT to be beyond ₹ "x" per unit.
5. **Procurement (खरीद) subsidies:** e.g. FCI purchasing at food grains from farmers at minimum support price (MSP).
6. **Interest (ब्याज) subsidies / subvention:** govt pays "x%" interest agriculture, MSME, affordable housing loans.

19.1.2 Impact of Subsidies (सब्सिडी का प्रभाव)

- Merit Goods (लाभदायक वस्तुएँ): Healthcare, education, scientific research, LPG, solar panels, wind mills etc. Here subsidies can increase the positive externalities. (Cheap LPG → poors don't use firewood → more trees & less indoor pollution.)
- But subsidies on diesel, kerosene generate negative externalities on the environment.
- Urea subsidies to industries → cheap urea to farmers → excessive consumption → soil & water pollution, algae-blooms.
- Subsidy leakage (सब्सिडी रिसाव): When ghost beneficiaries (non-existent persons propped up by corrupt officials), and ineligible people are receiving the benefits of subsidy.

19.1.3 Economic Surveys on subsidy delivery

Economic survey 2014-15:

- ✓ We should use _____ (JAM) trinity to reduce the subsidy leakage.

Economic survey 2015-16:

- ✓ Direct benefit transfer (DBT) can't be a panacea in every case, because males of the house may waste DBT-money on liquor & tobacco. So, in some cases, **Biometrically Authenticated Physical Uptake (BAPU)** mechanism will be better i.e. beneficiary goes to a grain / fertilizer shop and uses his Aadhaar & fingerprint to purchase subsidized goods.

Economic survey 2016-17:

- The present subsidy delivery mechanism suffers from two errors:
 - **Inclusion Error:** Non-poor (=affluent people) are receiving ~40% of subsidies
 - **Exclusion Error:** 50% of the real poor are not getting subsidies due to corruption.



- ✓ So better to abolish all type of subsidies and directly deposit a specific sum of money into beneficiary's bank account to help him buy goods/services from open market =
----- (UBI): More in Pillar#6.

19.2 REVENUE XPDR → SALARIES → 7TH PAY COMMISSION (वेतन आयोग)

Setup by Finmin → Department of Expenditure. 1st: Srinivasa Varadachariar (1946). 7th: (Retd.) Justice ----- (2014). Its recommendations became effective from 1/1/2016. Major highlights were:

- ✓ New system of “**Pay Matrix**” instead of previous system of pay band and grade pay.
- ✓ In regulatory bodies salaries increased: Chairman ₹ 4.50 lakh per month, members ₹ 4l.
- ✓ Minimum pay in Central service increased to ₹ 18k / per month (Group-D).
- ✓ Maximum pay: ₹ 2.25 lakh per month for Apex scale (e.g. Secretary of a Dept.), and ₹ 2.50l (for Cabinet Secretary)
- ✓ It adopted Dr. ----- **formula** to computing wages at periodic interval (formula tracks the changes prices of the commodities used by a common man). So, critiques believe there will not be an 8th Pay Commission because salaries will be updated automatically at regular interval, using this formula.
- ✓ It abolished various type of ‘interest free allowances’ e.g. Purchase of bicycle etc.
- ✓ It continued ‘interest-bearing advances’ for purchase of computer, house building (upto ₹ 25 lakhs). [= employee can borrow money from department but he will have to return it with interest.]
- ✓ Various reforms for defense and CAPF services.
- ✓ Made stronger rules in **Modified Assured Career Progression (MACP)** system so lazy officials don't get promoted.

19.2.1 Associated terms:

- **Dearness Allowance (DA: महंगाई भत्ता)**: It's given by an employer to protect the employees against rise in inflation. In government services, both working employees and retired pensioners are given dearness allowance.
- **House Rent Allowance (HRA: मकान किराया भत्ता)**: Component of an individual's salary that defines the rent allotted by the employer for employee's accommodation.
- **Gratuity (ग्रेच्युटी)**: It's a lump sum amount “x” given by an employer to the employee for rendering services continuously for “y” number of years. Usually given at retirement. Norms governed under Payment of Gratuity Act, 1972
- **one rank one pension (OROP)**: 2015- Modi govt. promised equal pension to military personnel retiring in the same rank with the same length of service, regardless of the date of retirement. Although, Ex-servicemen unhappy about the base year & calculation formula.

19.3 REVENUE DEFICIT (राजस्व घाटा: _____ OF GDP)

When government spends more than its income in revenue account, it incurs ...

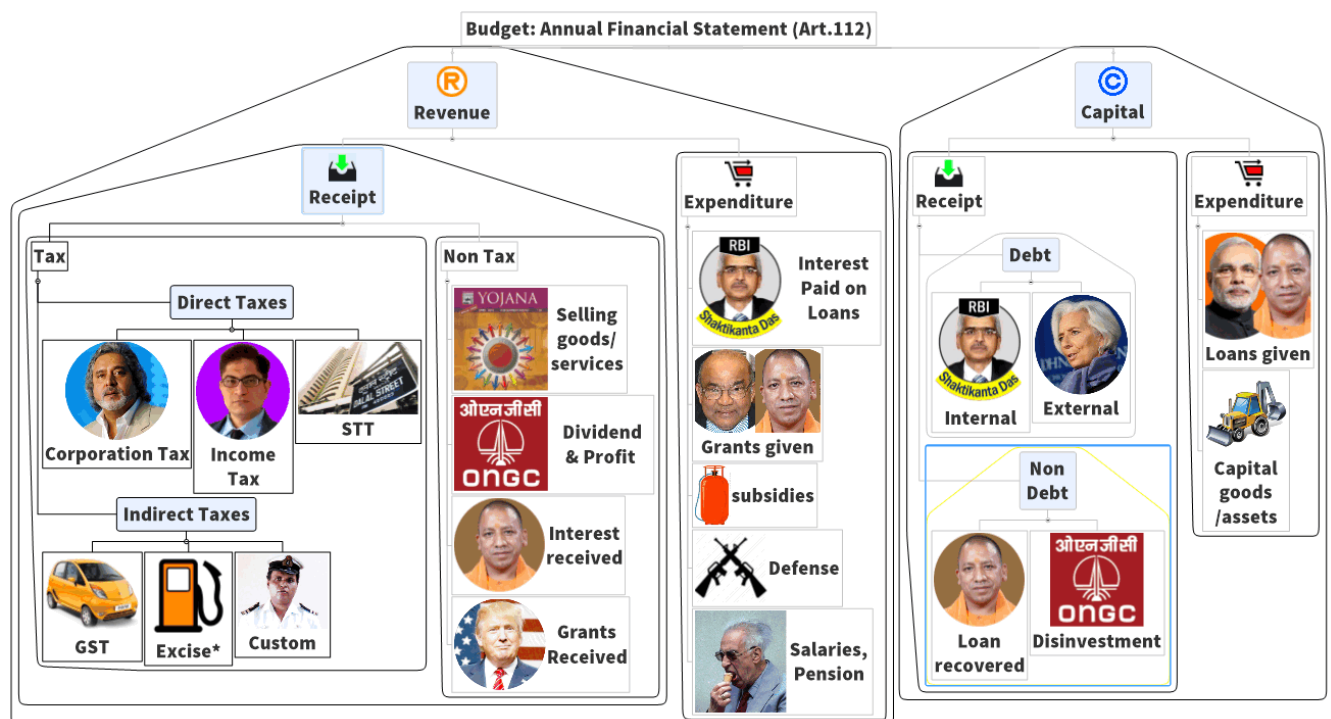


- Revenue deficit = Revenue expenditure – Revenue receipts.
- Since a major part of revenue expenditure is committed expenditure (like Interest repayment on previous loans, staff-salaries & pensions which Govt can't 'avoid'), so it is quite difficult to reduce the revenue deficit.
- So, when revenue deficit increases government will be forced to borrow more money or cut down the expenditure in the capital part (= less new schools, bridges and hospitals). This will result in lower human development and lower economic growth (less new bridges → less demand of steel/cements → less growth in those sectors).

19.4 EFFECTIVE REVENUE DEFICIT (प्रभावी राजस्व घाटा: _____ OF GDP)

- We've counted Grant-in-Aid to States / Local Bodies as 'Revenue Expenditure', but some portion of that money may have been used by the States / Local Bodies for building Panchayat-Bhavans, Disaster Management Training Institutes, Cranes & Bulldozers for Disaster rescue operations etc. which are actually "Capital Assets".
- Therefore, Budget 2011 (Chidambaram) introduced a new concept:
- **Effective Revenue Deficit** = Revenue Deficit (~4.7 lakh cr) MINUS Grants to various bodies which were spent for creation of Capital Assets (2 lakh cr)
- ERD= ~2.7 lakh crores (1.3% of GDP) for 2019-20.

20 BUDGET → CAPITAL PART → RECEIPTS(₹ ~68 LAKH CR)





बजट → पूंजी भाग > प्राप्तियां: Sub-classified into two parts (Figures in Interim-Budget-2019)

Capital Debt Receipts: पूंजीगत ऋण प्राप्तियाँ	Capital Non-Debt Receipts: गैर-ऋण पूंजी प्राप्तियाँ
₹ __ lakh cr from Internal Borrowing: <ul style="list-style-type: none"> - From RBI, - From market (Banks, NBFCs) - From small savings (Post-Office Savings Accounts, National Savings Certificates, etc), - From Provident Funds (EPFO, PPF) 	₹ 64,000 cr Loan Principal recovered (i.e. Union government would have given loans to state governments, foreign countries, public sector companies etc.) so when they return Principal amount back that is counted here.
₹ 44,000 cr External borrowing: from foreign countries & international institutions like IMF World Bank, BRICS bank etc.	₹ _____ cr Disinvestment i.e. Union selling its shares from Public Sector Undertakings (PSUs) / Central Public Sector Enterprises (CPSEs).
Bigger portion of Capital Receipts come from this side	Smaller portion

MCQ. Which of following is not a component of 'Capital Receipts'? (IEnggS-2018)

- (a) Market borrowings including special bonds
- (b) External loans raised by the Central Government from abroad
- (c) Receipts from taxes on property and capital transactions
- (d) Provident Funds (State Provident Funds and Public Provident Fund)

20.1 BUDGET → CAPITAL PART → RECEIPTS → DISINVESTMENT: विनिवेश

Public sector enterprise = Any commercial or industrial undertaking owned and managed by the government to maximise social welfare and uphold the public interest. They can be Classified into three parts:

Departmental Undertakings विभागीय उपक्रम	Statutory Corporations वैधानिक निगम	Govt. Companies सरकारी कंपनिया
Directly part of a ministry e.g. Postal, Railways, Ordnance Factories. They can be created easily, no laws required, no registration required	Created by an act of Parliament or state legislature. E.g. RBI Act, SBI Act, LIC Act, FCI Act, EPFO Act. etc, SIDBI, NABARD, NHB, EXIM..	Registered under the Companies Act, Govt's shareholding is 51% or more. Coal India Ltd, GAIL, SAIL, NTPC, IOCL, BHEL & various Public Sector Banks and NBFCs which are not statutory corporations.
High level of ministerial interference	Middle of both sides	More operational flexibility, less interference by Ministers
CAG will audit directly	Some of these Acts provide for internal audit & exclude CAG from auditing the Corporation. E.g. RBI, LIC.	Companies Act requires these companies to produce audited reports. CAG will empanel the (private) auditors



		for them.
Their earning will go directly in Public Account / CFI	Their earning → profit → dividend goes to shareholders.	
Answerable in RTI Act	Answerable in RTI Act	Answerable in RTI Act
Their employees are considered government employee- subjected to service and discipline rules framed by the government.	Not considered govt employees. Their service / discipline conditions are governed by the respective organizations' internal manuals.	

- **Public sector Undertaking (PSU)** = collective term for Centre's + State's + Local Bodies' Public Sector Enterprises.
- **Significance of corporations and companies:** Development of infrastructure, affordable services, regional balance, prevent concentration of economic power in the hands of Corporates and MNCs.
- **Challenges?** Political interference, lack of innovation & consumer responsiveness, employee unions, loss making enterprises.

20.1.1 Ratna Companies

Norms decided by Ministry of Heavy Industries & Public Enterprises. "Ratna Companies" given for the flexibility in operations like hiring more professionals, acquisition of other companies etc. without requiring government approval for every small decision.

Category	Condition and examples
Miniratna Cat-I and Cat-II	<ul style="list-style-type: none"> ✓ made profits in the last 3 years continuously, further subdivision in Cat-I & Cat-II depending on how much profit is generated. ✓ Examples: National Film Development Corporation Ltd, Mazagaon Dock Ltd, Airports Authority of India, Mishra Dhatu Nigam Ltd, NHPC Ltd, WAPCOS Ltd, ONGC Videsh Ltd, Rail Vikas Nigam Ltd,
Navratna	<ul style="list-style-type: none"> ✓ A Mini Ratna company fulfilling "x" conditions ✓ Other Govt companies fulfilling "y" conditions such as Manpower cost to total cost of production etc. ✓ Examples: Power Grid Corporation of India Ltd, Rashtriya Ispat Nigam Ltd, Rural Electrification Corporation Ltd, Shipping Corporation of India Ltd, Oil India Ltd, National Aluminium Company Ltd, Neyveli Lignite Corporation Ltd, Mahanagar Telephone Nigam Ltd, Hindustan Aeronautics Ltd, Container Corporation of India Ltd, Bharat Electronics Ltd,
Maharatna	<ul style="list-style-type: none"> ✓ Already a Navratna Company, and fulfilling "z" conditions such as min. ₹ 5000 crore profit per year in last 3 years, listed at a Stock exchange, significant global presence etc. ✓ Very few cos here: Bharat Heavy Electricals Ltd, Coal India Ltd, Indian Oil Corporation Ltd, NTPC Ltd, Oil & Natural Gas Corporation Ltd, Steel Authority of India Ltd, Bharat Petroleum Corporation Ltd,



*Above examples are taken on 1/3/19. Their status is subject to change and updation, but we need not did not lose sleep over it unless preparing for their specific recruitment exam.

20.1.2 Government policy towards disinvestment

- **Disinvestment:** Reducing the government shareholding upto 51%
- **Privatization:** Reducing the government shareholding below 50%
- **Arguments in favour:** reduced government shareholding → Private investors will enter in the board of directors → more efficiency, innovation and autonomy. Disinvestment proceeds can be used for welfare schemes, and reducing the fiscal deficit.
- **Argument Against:** MNC monopolies, exploitation of worker, job loss.

Year	Policy
1991's Industrial Policy	Reduce shareholding in all Govt Companies
1998's Vajpayee	<ul style="list-style-type: none"> - In strategic sector (Railways, Defense, Atomic Energy)- we'll not do disinvestment - In Non-strategic = phased disinvestment
UPA-1 (2004-09)	Due to pressure from the left is parties in the coalition: No Disinvestment from any government companies. If a government company is sick, we will try to revive it.
UPA-2 (2009-14)	<ul style="list-style-type: none"> - All Govt Companies can be disinvested upto 49%. Money will goto National Investment Fund (NIF: Public Account) → used for Bank recapitalization, metro rail, nuke energy, EXIM-NABARD-RRB etc. - Also launched CPSE-Exchange Traded fFunds (ETF): <i>Ref SEBI handout</i>

20.1.3 Disinvestment & Privatization in the Modi Raj (2014-19)

- ✓ Tried three methods of Disinvestment, depending on the Company
 - CPSE-ETF, Bharat-22-ETF
 - Institutional placement Programme (IPP): offer shares only to non-retail investors
 - Offer for sale (OFS): offer shares to both retail and non-retail investors
- ✓ Modi govt shut down many sick Govt companies such as HMT watches, Hindustan Photo Film etc.
- ✓ Budget-2016 renamed FinMin's Dept of Disinvestment into Dept. of Investment & Public Asset Management (DIPAM).
- ✓ **Disinvestment targets last 3 budgets:** ₹ 1lcr (2017: Target achieved), ₹ 80k cr (2018: Target achieved), ₹ 90k crore (2019).
- ✓ **Privatisation attempts in 2018:** (1) Tried to sell-off 74% shareholding from AirIndia but no investors found. (2) IDBI sold to LIC.

MCQ. Why is the Government of India disinvesting its equity in the Central Public Sector Enterprises (CPSEs)? (Asked in UPSC-Pre-2011)

1. The Government intends to use the revenue earned from the disinvestment mainly to pay back the external debt.



2. The Government no longer intends to retain the management control of the CPSEs.

Ans Codes: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

20.2 BUDGET → CAPITAL PART → EXPENDITURE (₹ ~63 LAKH CRORES)

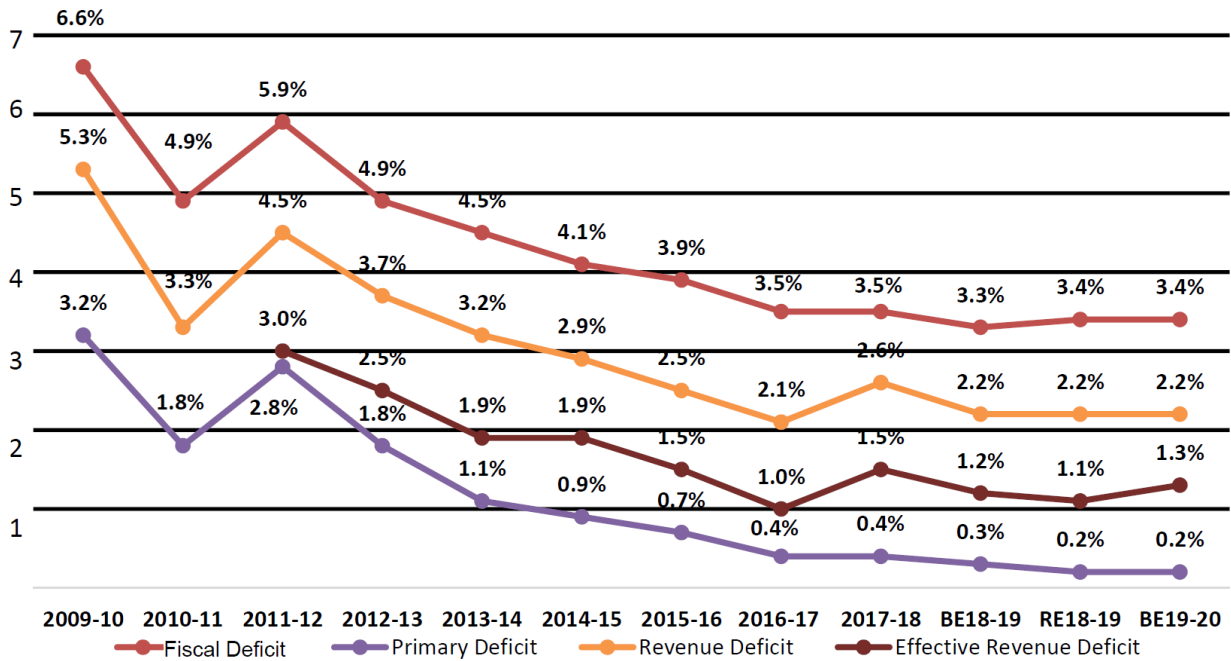
बजट → पूंजीगत भाग → व्यय

Capital Expenditure: पूंजीगत व्यय	Interim-2019 (₹ lakh cr): अन्तरिम-2019
Capital assets for various schemes, ministries, departments (Building, vehicles..)	1.18 lakh crores
Repaying of loan principal for internal debts	60 lakh crores
Repaying of loan principal for external debts	35,000 cr
Giving Loans to CPSEs, State Govt, Foreign Govt etc.	91,000 cr.
Total Capital Expenditure	63 lakh crores

21 TYPES OF DEFICITS: घाटे के प्रकार

- If government's income >> its expenditure it will have a **surplus budget**/ अधिशेष बजट
- If government's expenditure == its income, it will be a **balanced budget**/ संतुलित बजट
- If government's expenditure >> its income, it'll be a **deficit budget**/ घाटे का बजट

Deficit	Formula	Interim-2019 (₹ lakh cr)
Revenue Deficit राजस्व घाटा	Revenue expenditure – Revenue receipts	4.70 lcr. (2.2% of GDP)
Effective Revenue Deficit प्रभावी राजस्व घाटा	Revenue Deficit minus Grants for creation of capital assets	2.70 lcr. (1.3% of GDP)
Budget Deficit बजट घाटा	Budget expenditure minus Budget receipt	00
Fiscal Deficit राजकोषीय घाटा	Budget Deficit	7.00 lcr. (_ _ _ of GDP)
Primary Deficit प्राथमिक घाटा	Fiscal Deficit minus	39000 cr. (0.2% of GDP)



MCQ. Find Correct Statement(s) (Asked in UPSC-Pre-2017)

1. Tax revenue as a percent of GDP of India has steadily increased in the last decade.
2. Fiscal deficit as a percent of GDP of India has steadily increased in the last decade.

Codes: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

21.1 FISCAL DEFICIT: राजकोषीय घाटा

- **Fiscal Deficit** = Budget Deficit + Borrowing. *This borrowing includes borrowing at home (such as through Small Savings Scheme, and the G-Secs subscribed by Banks/NBFCs) + Borrowing from RBI + Borrowing from abroad.*
- Alternatively, we can expand formula as Fiscal Deficit = Total expenditure – (Revenue receipts + Non-debt capital receipts).

21.2 PRIMARY DEFICIT: प्राथमिक घाटा

- If the government continues to borrow year after year, it leads to accumulation of debt and the government has to pay more and more interest. These interest payments themselves contribute to borrowing requirements next year.
- So, to get a clearer picture of how much is the government borrowing for new programs, they look at another indicator:
- **Primary Deficit** = Fiscal deficit minus the interest to be paid on the previous loans.

21.3 FINANCING THE DEFICIT AND ITS NEGATIVE CONSEQUENCES ON ECONOMY:

घाटे का वित्तपोषण: अर्थव्यवस्था पे उसके नकारात्मक परिणाम

Deficit can be financed by either taxation, borrowing or printing money.

- Taxes can't be increased beyond a point because it may force people to evade taxes / discourage their motivation to work. (recall Laffer Curve).



- High deficit → Government borrows more money → @Maturity of G-Sec, it will have to return the principal and interest to the lenders. At that time, Govt may greatly increase taxes on people to arrange that amount. So, Economist David Ricardo argued that during high deficits, people save more, because they become pre-cautious about future hike in taxes. It's called "**Ricardian equivalence: रिकार्डियन तुल्यता**" [& if people begin to spend less and save more, then companies will face unsold inventories, creating new set of problems]
- If government borrows more money from households & financial intermediaries (LIC, EPFO, Banks via SLR), then that much less money will be available for loans to private corporate borrowers. = "_____ : **हासकारी प्रभाव**" on the private borrowers= harms factory expansion and job creation.
- If Government forces SBI, LIC, EPFO to buy its G-sec using public deposits and thereby depriving households of the optimal return (Had the same money been invested in the corporate sector) = "_____ **of the households: घरों/ कुटुम्बों का वित्तीय दमन**".
- High level of fiscal deficit → International credit rating Agencies will reduce the sovereign rating → investors will demand more interest from government for buying new G-Sec → G-sec remains unsold → RBI forced to buy it (and print more money to give to Govt) → it's called "_____ : **मुद्राकृत घाटा**". It can result in hyperinflation and reduce the purchasing power of currency (if there is not sufficient increase in the supply of onion, tomatoes & goods in the market.) e.g. Germany, after Treaty of Versailles (1919).

21.4 FISCAL CONSOLIDATION / PRUDENCE: राजकोषीय एकत्रीकरण / विवेक

It involves reduction in government expenditure to control its Fiscal Deficit. Such as

1. Reducing the scope of leakages by targeted delivery of schemes and subsidies through direct benefit transfer (DBT) through JanDha- Aadha- Mobile (JAM) trinity.
2. Reducing the quantum of subsidies: e.g.
 - a. Deregulation of Petrol prices (2010), Diesel Prices (2013).
 - b. 2016: Oil Ministry began to block LPG-Pahal subsidies to persons with annual taxable income of ₹ 10 lakh />
 - c. 2017: Oil Ministry asked oil companies to keep raising prices of subsidised kerosene by 25 paise every fortnight until the subsidy is eliminated.
3. Shutting down loss making PSU. E.g. Hindustan Photo Films, HMT Bearings, HMT Chinara Watches, Tungbhadra Steel, Hindustan Cable & HMT Watches (2014).
4. Privatization of loss making PSU/PSBs e.g. 2018- IDBI2LIC, 2018- Tried to sell off Air India, but unable to find any buyer.
5. Austerity Measures: मितव्ययिता के उपाय e.g. 2018- W.Bengal govt issued directives to its departments banning flower bouquets and mementoes in public functions, banning officials meetings at private hotels, frequent installation of AC, car purchases, office renovations etc. & restricting the number of foreign tours by Ministers / IAS etc., More use of video-conferencing instead of personal tours.



MCQ. There has been a persistent deficit budget year after year. What can be done by the government to reduce the deficit? (Asked in UPSC-Pre-2015)

- 1) Reducing revenue expenditure 2) Introducing new welfare schemes
3) Rationalizing subsidies 4) Expanding industries
Answer Codes: (a) 1 and 3 only (b) 2 and 3 only (c) 1 only (d) 1, 2, 3 and 4

MCQ. In India, the price of petroleum products has been deregulated mainly to (UPSC-CDS-2013-II)

- (a) reduce the burden of subsidies given to the oil companies
(b) discourage the exploration of oil reserves in the country
(c) discourage the demand for private vehicles
(d) curb the use of black money in the economy

21.5 FISCAL STIMULUS (राजस्व प्रोत्साहन पैकेज)

- When government reduces taxes and/or increases public procurement (सरकारी खरीद) to boost the demand & growth in economy, it's called "*Fiscal Stimulus*".
- Post-subprime crisis in USA, Manmohan Govt. announced Fiscal Stimulus (2008) such as (1) Cut in the Excise duty & Custom Duty on exports (2) Businessman where given additional depreciation benefits in Income Tax & Corporation Tax, if they purchased new commercial vehicles. (3) Hiked the MSP procurement prices for farmers.
- However, the economic surveys observed that such Fiscal Stimulus create new set of problems by increasing the fiscal deficit in the subsequent years.

MCQ. Which one of the following statements appropriately describes the "fiscal stimulus"? (Asked in UPSC-Pre-2011)

- (a) It is a massive investment by the Government in manufacturing sector to ensure the supply of goods to meet the demand surge caused by rapid economic growth
(b) It is an intense affirmative action of the Government to boost economic activity in the country
(c) It is Government's intensive action on financial institutions to ensure disbursement of loans to agriculture and allied sectors to promote greater food production and contain food inflation
(d) It is an extreme affirmative action by the Government to pursue its policy of financial, inclusion

21.6 _____, 2003 (FRBM)

राजकोषीय उत्तरदायित्व और बजट प्रबंधन अधिनियम, 2003

Originally it required Union and States to control their deficits with following targets:.

- By 2008: Reduce Fiscal Deficit to 3% of GDP (for Union) and 3% of GSDP (for States).
- By 2008: Eliminate Revenue deficit (=make it 0%) of their respective GDP or GSDP.

While some of the state governments were able to do it, but successive union government struggled to meet these targets so they kept amending the act to extend the deadlines and targets. E.g. Amendment 2012: No need to have 0% Revenue deficit. Instead it required 0%



Effective Revenue Deficit by 2015. These deadlines were extended even further in subsequent Finance Bills.

21.6.1 FRBM Review Panel under _____ (2016-17); समीक्षा पैनल

- **Budget-2016:** Jaitley felt FRBM Act targets were too rigid and did not allow any room for the government to address any crisis e.g. farm loan waivers during drought period or unemployment allowance during global financial crisis are not possible if government strictly wants to control fiscal deficit at 3% of GDP.
- So, he constituted a panel under NK Singh (former IAS, 15th FC chairman) to review the FRBM act. RBI Governor Urjit R. Patel & CEA Arvind Subramanian were also in the committee.

21.6.2 FRBM Panel's Notable recommendations: उल्लेखनीय सिफारिशें?

- Replace the existing FRBM act with a new act, with an ' _____ ' i.e. During a war, drought or economic crisis, the government should be temporarily allowed to cross breach targets.
- Set Up an independent Fiscal Council for monitoring.
- Adopt following fiscal road map for the union from 2017 to 2023 gradually reduce Union Debt to GDP (to less than 40%), Fiscal Deficit (to 2.5%) and Revenue Deficit (to 0.8%)

So, citing NK Singh report (as an excuse), Budget 2018 amended the FRBM targets →

Indicator as % of GDP	(Actual) 2018-19	(Actual) 2019-20	(TARGET) 2020-21	(TARGET) 2024-25
Fiscal Deficit	3.4%	3.4%	_____ %	3.0%
Primary Deficit	0.2%	0.2%	_____ %	0.0%
Revenue Deficit & ERD	These targets are abandoned in FRBM			
Union Debt: GDP	In 2017, it's ~46.5%, Gradually reduce it to →			_____ %
General (=Union+State) Debt to GDP:	Gradually reduce to →			_____ %

FRBM Act requires the union government to present 3 documents along with the budget:

1. **Fiscal Policy Strategy Statement (राजकोषीय नीति कार्यनीति विवरण):** To explain how Govt. is controlling the deficits, and whether there is going to be any deviation from the target.
2. **Macroeconomic Framework Statement (व्यापक आर्थिक ढाँचा विवरण):** to show economic data - GDP, growth rate, import-exports, and government's receipts and expenditure etc.
3. **Medium-term Fiscal Policy Statement (मध्यम अवधि की राजकोषीय नीति विवरण):** for next 3 year projections



		Revised Estimates	Budget Estimates	(Projections)	
		2018-19	2019-20	2020-21	2021-22
1.	Fiscal Deficit	3.4	3.4	3.0	3.0
2.	Revenue Deficit	2.2	2.2	1.7	1.5
3.	Primary Deficit	0.2	0.2	0.0	0.0
4.	Gross Tax Revenue	11.9	12.1	12.1	12.2
5.	Non-tax Revenue	1.3	1.3	1.3	1.3
6.	Central Government debt	48.9	47.3	45.4	43.4

(Concept) Fiscal Slippage: If government has targeted to keep the fiscal deficit within 3.4% percent of GDP, but if it crosses that limit, it's called '**Fiscal Slippage**'.

MCQ. According FRBM Act, the Government is under obligation to present three statements before the parliament along with the Annual Budget. Which one of the following is not one of them? [UPSC-CDS-2008-I]

- (a) Macroeconomic Framework Statement
- (b) Fiscal Policy Strategy Statement
- (c) Medium-term Fiscal Policy Statement
- (d) Statement showing Short term Fiscal Policy

21.6.3 Public Debt Management Agency (PDMA): सार्वजनिक ऋण प्रबंधन एजेंसी

- RBI decides on the repo rate and also undertakes open market operation for buying and selling of G-sec. Most of the G-sec are purchased by public sector banks, insurance and pension funds. As Banking-regulator, the Reserve Bank is able to nudge PSBs to subscribe to G-sec. So, this creates a 'conflict of interest' for RBI in its role as Banking regulator vs Public Debt manager.
- Budget-2015 proposed creating an independence Public Debt Management Agency (PDMA) to takeover these functions of RBI. But later plan was put on a back burner due to RBI's objections.
- 2019: NITI Aayog Vice Chairman Rajiv Kumar again reiterated the need to setup PDMA.

22 TYPES OF BUDGET: बजट के प्रकार

22.1 REVENUE VERSUS CAPITAL BUDGET: राजस्व बनाम पूंजीगत बजट

Revenue budget: राजस्व बजट	Capital Budget पूंजीगत बजट
It is associated with the income and expenditure that are of temporary in nature (1 year or less), and/or do not result into	associated with the income and expenditure that are of long term nature and/or results into creation of permanent / capital /financial



creation of permanent / capital / physical / financial assets.	assets, such as land, buildings, machinery, equipment, shares, bonds, G-sec.
Taxation, revenue from selling goods and services, interest payment on previous loans, salaries, pension, subsidies and other non-developmental expenditure	Borrowings, disinvestment, and expenditure on assets creation.

MCQ. Which of the following is/are included in the capital budget of the Government of India? (Asked in UPSC-Pre-2016)

1. Expenditure on acquisition of assets like roads, buildings, machinery, etc,
2. Loans received from foreign governments
3. Loans and advances granted to the States and Union Territories

Ans Codes: (a) 1 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

22.2 GENERAL BUDGET VERSUS RAILWAY BUDGET (आम बजट बनाम रेलवे बजट)

- 1920-21: _____ Committee recommends separate Railway Budget. This practice continued even after Independence, first the railway minister would present the Railway budget in parliament, and after a few days finance minister will present General Budget.
- NITI Aayog's Bibek Debroy committee recommends its abolition because 1) No constitutional requirement 2) During coalition governments, Rail budget was used for populism, cheap fares which eroded the profitability of Railways. 3) during the British time, railway revenue used to be quite large compared to other sources of revenue, but after independence, Railway revenue is quite small compared to overall General budget- So it does not deserve a special presentation.
- Therefore, Modi govt merged Railway budget merged with General budget from 2017.

22.3 PLAN VS NON PLAN EXPENDITURE BUDGET:

योजना बनाम गैर योजना व्यय बजट: is a method of classifying the expenditure side

Plan (expenditure) budget;	Non-Plan (Expenditure) Budget
<ul style="list-style-type: none"> - Central Plans (the Five-Year Plans) - Central assistance for State Five Year Plans. - It is further subdivided into revenue expenditure (e.g. teachers salary under Sarva Shiksha Abhiyan) and capital expenditure (e.g. new school buildings to be constructed under Sarva Shiksha Abhiyan) 	<ul style="list-style-type: none"> - Expenditure related to general, economic and social services of the government; Interest payments, defence services, subsidies, salaries and pensions. - It is also further subdivided into revenue expenditure (e.g. soldier salaries) and capital expenditure (e.g. Building new aircraft carrier).

Since Budget-2017, Modi govt stopped the practice of displaying the plan and non plan expenditure separately because (1) No such constitutional requirement (2) Government had dissolved the planning commission in 2014-15 (3) 12th Five Year Plan (2012-17) was ending in 2017 anyways.



22.4 BUDGETING

It is the process / strategy with which the budget is created.

Traditional / Line-item Budgeting	<p>पारंपरिक / लाइन-आइटम बजट: Simply calculating the income and expenditure without measuring the underlying benefit or performance</p> <ul style="list-style-type: none"> - Allot ₹ 10,000/- to buy a New bed in government hospital - Allot ₹ 50,000 to buy a new computer in government department
Performance budgeting प्रदर्शन बजट	<p>calculating the income and expenditure tied with underlying benefit or performance</p> <ul style="list-style-type: none"> - Allot ₹ 50,000 to buy a new computer with target that it should result in 30% the faster clearance of RTI-applications compared to pen and paper based office system. <p>Such budgeting helps measuring everything in terms of cost:benefit, efficiency.</p>
Zero based budgeting शून्य आधारित बजट	<ul style="list-style-type: none"> - In a traditional budgeting, the approach is “automatic and incremental, “last year we allotted ₹ 50,000 crore to educational schemes, so this year we should allot 55,000 crores, lest the opposition parties create controversy.”. - Whereas in Zero based Budgeting the budget is viewed as a fresh exercise from zero base. So, each department has to justify its budget demands to finance ministry. E.g. if last year ₹ 50,000 crores given to education schemes but still 60% of class 5 kids cannot read class 2 books, then we'll delete / modify that scheme.
----- Budgeting सूर्यास्त/ समयसीमा का बजट	<ul style="list-style-type: none"> - In a traditional budgeting, once a scheme is launched it runs perpetually, even after regime change e.g. MNREGA, Mid-day Meal. - In a zero based budgeting, schemes are reviewed every year and then they may get discontinued or continued (with or without modifications). - In Sunset Budgeting, scheme are announced with deadline. e.g. MEITY to give MDR subsidy for a period of two years starting from 1/1/2018. Thus, this scheme will self destruct after deadline just like the sun will set after the sunset time.
----- लैंगिक बजट	<p>It is not a separate budget but rather within the general budget, FinMin will put a separate expenditure document showing women specific schemes, targets, and commitments- in two parts:</p> <ul style="list-style-type: none"> ✓ Part A = Women Specific Schemes, i.e. which have 100% allocation meant for women. E.g. Minority Affairs Ministry's “Nai Roshni” scheme for Leadership Development of Minority Women, ✓ Part B = Pro Women Schemes, i.e. where at least 30% allocation is meant for women. E.g. HRD Ministry → Sarva Shiksha Abhiyan. ✓ Practice started from Budget-2005.

22.5 TRIBAL SUB PLAN & SCSP

From 70s, Govt required individual ministries to earmark funds for SC/ST within their overall funds, under the titles:



- A. “**Scheduled Castes Sub-Plan (SCSP: अनुसूचित जाति उप-योजना)**” → Social Justice Ministry monitors via **e-utthaan.gov.in**
- B. “**Tribal Sub plan (TSP: आदिवासी उप योजना)**” → Tribal Affairs Ministry monitors via **stcmis.gov.in** which is not a fancy name so we need not memorize unlike e-utthaan.

22.6 OUTPUT OUTCOME FRAMEWORK FOR SCHEMES:

योजनाओं के लिए उत्पादन परिणाम ढाँचा

Started from Budget-2017 onwards, the FinMin uploads a document showing outlay output and outcomes for each ministry and department. These are monitored by NITI Ayog. e.g.

Ministry & Scheme	Outlay	Output (Deliverables)	Outcome
MEITY → Pradhan Mantri Gramin Digital Saksharta Abhiyan (PMGDISHA)	₹ 400 crores	Give computer training to 5 crore persons in rural area	Increased number of digitally literate persons in rural areas

22.7 LAPSABLE FUNDS & MARCH RUSH: व्यपगत निधि और मार्च व्यस्तता

- Appropriation act allows the government to spend funds from consolidated fund of India for a period of one year (ending in 31st March).
- If any allotted funds remain unutilised, then by the ‘_____’, they must be returned (& government will have to again seek Parliament approval for the next financial year using next appropriation bill).
- So, in March, there is rush among the Government organisations to spend money (in a haphazard / reckless manner) lest they’ve to return it back.
- 2017-18: Finance ministry issued directive that in “*In the fourth quarter (Jan to March) and in the March-Month, Govt organizations shall not spend more than “x%” & “y%” of funds*”. This helps controlling the March Rush.

22.8 NON LAPSABLE FUNDS & NO RUSH: बिनव्यपगत निधी

- The money in such fund will not lapse on 31st March, so it can be used in future without getting another approval from parliament. e.g. Department of economic affairs → _____ → women safety related projects.
- **Criticism?** because the fund is non lapsable, Departments become very lax in utilising it. Budget 2013 started Nirbhaya fund in the aftermath of Dec-2012 Gangrape @Delhi. The successive budgets kept adding ₹ into it. By 2018: ~3000 crore but not even 50% utilized for any women safety activities.
- 2018: Defence ministry demands “non lapsable defence modernization fund”, but Finance ministry rejected the proposal for similar same reason. (money will remain unspent.)



22.9 CASH VS ACCRUAL BUDGETING: नगदी बनाम उपचय बजट

If Railways transported cargo of Jindal Steel in January, & raised ₹ 5 lakh invoice but Jindal actually paid money in February. Then, Railways account book can be prepared in 2 ways:

Income	Cash based accounting नकद आधारित लेखा	Accrual-based accounting उपचय आधारित लेखा
January	₹ 0	₹ 5 lakhs (it's deemed as 'earned' even though it's not 'paid' right now)
February	₹ 5 lakhs (i.e. when cash actually received / spent).	₹ 0
So?	Since colonial times, Govt. preparing accounts and budget in this manner.	<ul style="list-style-type: none"> - 12th FC suggest to use this method, for better estimation of income and expenditure. HOW? #BcomNOTIMP. - From 2019 Railways planning to adopt this. So, TheHindu columnists suggesting that all depts shd adopt

22.10 TYPES OF SCHEMES/ योजनाओं के प्रकार

- UPA/Congress Raj: hundreds of centrally sponsored schemes (CSS) with overlapping objectives and duplication of efforts.
- 2015-16: NITI Ayog forms Shivraj Singh Chouhan Panel for rationalization CSS → cabinet approved report → reduced, merged & restructured. Ultimate outcome is →

Central Sector Schemes केंद्रीय क्षेत्र की योजनाएं	Centrally Sponsored Schemes केंद्रीय प्रायोजित योजनाएं
_____ funded by Union	Not 100% funded by union. States have to bear some cost.
Examples: Urea Subsidy, MDR Subsidy, Jan Aushadhi Scheme, BharatNET, Pradhan Mantri Gramin Digital Saksharta Abhiyan (PMGDISHA) etc.	Further subtypes: 1. _____ (अति महत्वपूर्ण योजनाएँ): a. Only 6 schemes: MNREGA, NSoAP, Umbrella schemes for SC,ST,Minorities & other vulnerable groups. For these schemes, UPA-era funding pattern will continue. b. Those schemes deal with social protection and social inclusion are given first priority in the funding for National Development Agenda 2. _____ Scheme (महत्वपूर्ण योजनाएँ): e.g. PM Gram Sadak, PM Awas, Swachh Bharat, AMRUT & Smart cities etc. Here funding pattern could be 50:50, 60:40, 70:30, 75:25, 80:20 or 90:10 depending on a particular scheme and depending on whether it's a general / special cat. state.
Int-Budget-2019: ₹8.60lcr	Interim Budget 2019 allotted ₹ 3.27 lakh crores here.



- ** In 2016, the third category of Centrally Sponsored Schemes was “Optional Schemes” viz. 1) Border Area Development Programme 2) Shyama Prasad Mukherjee Rurban Mission with funding pattern (50:50 | 80:20), But over the years they are shifted in the schemes.
- For any union territory without legislature: 100% funding by Union for any scheme in any category. We will look at the schemes’ features in the respective pillars.

22.10.1 Mock Questions for UPSC Mains GSM3 (250 words each)

1. What are the terms of reference of the 15th finance commission? Why are some state governments apprehensive about them? १५वें वित्तीय आयोग के विचारार्थ विषय क्या है? कुछ राज्य इस विषयमें आशंकावान क्यों हैं?
2. “The constitution of GST Council has reduced the role of Finance Commission as the balancing wheel of fiscal federalism in India.” Do you agree? Justify your stand. "जीएसटी परिषद के गठन ने वित्त आयोग की भारत में राजकोषीय संघवाद के संतुलन में भूमिका को कम कर दिया है।" क्या आप सहमत हैं? अपने तर्क को उचित ठहराएं।
3. (Asked in GSM3-2018) Comment on the important changes introduced in respect of the Long-term Capital Gains Tax (LCGT) and Dividend Distribution Tax (DDT) in the Union Budget for 2018-2019. केंद्रीय बजट 2018-2019 के दीर्घकालिक पूंजीगत कर (एलसीजीटी) और लाभांश वितरण कर (डीडीटी) के संबंध में पेश किए गए महत्वपूर्ण परिवर्तनों पर टिप्पणी करें।
4. (Asked in GSM3-2016) Discuss the requirements and status of gender budgeting in the Indian context? भारतीय संदर्भ में लिंग बजट की आवश्यकताएं और स्थिति चर्चा कीजिए.
5. (Asked in GSM3-2013) What are the reasons for introduction of Fiscal responsibility and Budget Management (FRBM) act, 2003? Discuss critically its salient features and their effectiveness. राजकोषीय उत्तरदायित्व और बजट प्रबंधन (FRBM) अधिनियम, 2003 को लागू करने का क्या कारण है? इसकी प्रमुख विशेषताओं और उनकी प्रभावशीलता पर गंभीर रूप से चर्चा करें.
6. (Asked in GSM3-2013) Money laundering poses a serious threat to country's economic sovereignty. What steps are required to be taken to control this menace? मनी लॉन्ड्रिंग देश की आर्थिक संप्रभुता के लिए एक गंभीर खतरा है। इस खतरे को नियंत्रित करने के लिए क्या कदम उठाए जाने की आवश्यकता है?