



# **B U D G E T**

## **2005 - 2006**

**SPEECH OF**  
*THE MINISTER FOR FINANCE*  
**Thiru C. PONNAIYAN**

**Maasi 18, Thiruvalluvar Aandu 2036**  
**2nd March, 2005**

**Speech of Thiru C. Ponnaiyan, Minister for Finance,  
Government of Tamil Nadu, presenting the Budget for  
2005-2006 to the Legislative Assembly on 2<sup>nd</sup> March,  
2005**

**Honourable Speaker Sir,**

முறைசெய்து காப்பாற்றும் மன்னவன் மக்கட்(கு)  
இறையென்று வைக்கப்படும்.

(A King who safeguards the welfare of his subjects by just and upright rule will be considered a divine being in human form.)

With these memorable words of Saint Tiruvalluvar, which so aptly describe the rule of our sagacious, munificent, visionary leader, the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa, I rise to present the Revised Estimates for 2004-2005 and the Budget Estimates for 2005-2006. I proceed with my task with the blessings of our noble leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa who with firm resolve, true grit, total dedication and crystal clear clarity of action has transformed Tamil Nadu from the abyss of gloom and despair at the end of the rule of the previous Government to a land of prosperity for all, abundant opportunities for its people and powerful growth marching steadily to the Numero Uno position among Indian States.

2. The people of Tamil Nadu gave a resounding mandate to the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa in May 2001, to rescue the State from fiscal penury, economic stagnation, insecurity and drift that the State found itself at the end of the rule of the previous Government. Today our leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa has fulfilled this mandate restoring Tamil Nadu to its erstwhile glory, all round

development, prosperity and a happy life for its people free from the fear of violence and disorder. Tamil Nadu under the able and dynamic leadership of our leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa has left behind the shackles imposed by the dull, desultory and pusillanimous rule of the previous Government which only led to chaos and misery. It has taken a supreme effort by our leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa to set right the financial position, take Tamil Nadu forward on a new development path and bring peace and prosperity to the people of Tamil Nadu. No one else could have achieved this daunting task in the face of such multiple and complex adversities. The very fact that every Tamilian today can stride purposefully forward, with head held high, is the best tribute that can be paid to our visionary leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa for this outstanding achievement overcoming all obstacles.

3. Hon'ble Members of this House may recall the totally hopeless fiscal position that engulfed the State in May 2001 when this Government assumed office. The very credibility of the Government was shaken with bills not being honoured and development works being suspended. It was virtually an impossible task to rescue the State from the depths to which it had sunk. Hon'ble Members of the House are aware that fiscal reform is not a goal in itself but a necessary means to ensure rapid development providing more employment, improved incomes and better quality of life to the people. When fiscal reforms to ensure rapid development became inescapable, our leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa saw to it that the correction was made quickly and the poor were protected throughout the entire process. It is only in Tamil Nadu starvation deaths were totally prevented. In no other State has such a major fiscal adjustment been achieved in such a short span, while at the same time ensuring that the poor are

completely protected from the rigours of fiscal adjustment. The success achieved by our Government in accomplishing fiscal reforms and taking the State back on the road to rapid development and prosperity is only due to the bold, dynamic, steadfast and compassionate leadership of our leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa.

4. Hon'ble Members of the House are aware of the development paralysis caused in several States due to terrorism, insurgency, militancy and extremism, not to mention the incessant break down of law and order for routine reasons. In Tamil Nadu, people are guaranteed safety and security. It is easy to take this for granted. This would be a big mistake as we witness the incidents across the State border. We all have to join in saluting our leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa for the indomitable, courageous, bold and daring leadership which has held the State together keeping at bay all those mischievous and fissiparous forces which always look for an opportunity to tear our social fabric apart. This is what makes our leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa a leader among all leaders, a leader nonpareil, a person of clear conviction, uncompromising stance in the war against terrorism and extremism, meticulous planning, brilliant strategic interventions and firm faith in making the Tamil Nadu Police an effective instrument guarding the citizens from the travails of a soft State. The elimination of the dreaded forest brigand Veerappan and his gang, ridding the State of a murderous menace is an outstanding achievement made possible only by the unwavering and unflinching commitment and action of our leader. No praise would be excessive for the tireless, dedicated service of our leader the Hon'ble Chief Minister Puratchi Thalaivi J Jayalalithaa in protecting and safeguarding the people of Tamil Nadu.

that the Revenue Deficit has been brought down to 4.64 % of the Total revenue Receipts. This shows that the State is well on course to meet the targets fixed under the Fiscal Responsibility Act 2003. The Fiscal Deficit of the Government for the year 2005-2006 is estimated to be Rs. 6350.57 crores. This includes Rs. 232.30 crores of expenditure incurred through off budget borrowings pertaining to the prior period. The Fiscal Deficit (excluding prior period expenditure) in the Budget Estimates 2005-2006 has been brought down to 2.86% of the Gross State Domestic Product (GSDP).

## **TAX REFORM**

### **VALUE ADDED TAX (VAT) SYSTEM**

169. Hon'ble Members of the House are aware of the decision of the Empowered Committee of State Finance Ministers and the Government of India about the introduction of a State level Value Added Tax (VAT) system to replace the State Sales Tax from 1.4.2005. In a significant meeting of all Chief Ministers convened on November 16, 1999, by the then Union Finance Minister, a decision was taken that steps would be initiated by the States for introduction of State level VAT after adequate preparation. For implementing this decision, the Empowered Committee of State Finance Ministers was set up. Thereafter, the Empowered Committee met regularly and steps were initiated for systematic preparation for the introduction of State level VAT.

170. There was a decision to introduce Value Added Tax (VAT) from 1.4.2003. However this was postponed. In the Empowered Committee meetings it was conveyed that a State like Tamil Nadu which has already incorporated many of the features of a VAT system, is likely to incur a huge loss of revenue

on account of implementation of VAT. It was stressed that it would expose the State to a large financial risk.

171. In November 2004, the Union Finance Minister announced that the Central Government would provide 100% compensation to the States in the year 2005-2006, 75% in the year 2006-2007 and 50% during 2007-2008 for loss, if any, on account of introduction of VAT. We have asked for full compensation till the revenue under VAT system stabilizes. Since the Government of India did not agree to provide full compensation for the loss on introduction of VAT the Empowered Committee of State Finance Ministers headed by the Hon'ble Finance Minister of West Bengal, with a majority decision, has proceeded to draw a time table for the introduction of Value Added Tax system in all States with effect from 1.4.2005 with this compensation formula. The Empowered Committee had also convened a meeting at Chennai on 30.1.2005 to explain the features of the proposed Value Added Tax system.

172. Although there has been a determined effort to reach a national consensus on the introduction of a Value Added Tax system, there are still certain apprehensions about how it will affect different sections in the value chain. It is therefore necessary to indicate the features of the State Value Added Tax system which has been laid down by the Empowered Committee of State Finance Ministers in association with the Government of India. The basic structure of the State Value Added Tax system is to ensure that there is no tax on tax. In the usual multi-point tax system, tax is levied on goods which had already suffered tax in the previous stage, whereas in a Value Added Tax system, tax is levied at each stage, only on the value added after giving due set off to the tax paid at the previous stage. This is the underlying principle on which the State Value Added Tax system has been formulated.

173. With a State Value Added Tax system, all other levies such as Additional Sales Tax, Surcharge and Resale Tax will be abolished. The Entry Tax paid will be fully adjusted against the tax payable under Value Added Tax. The tax rates will be common throughout the country and will consist of a 4% tax for essential and agricultural commodities and 12.5% rate for all other goods. A special rate of 1% will be levied on bullion, jewellery, etc. A few items such as Petrol, Diesel, IMFS, etc. will be outside the scope of the Value Added Tax system and will carry special rates.

174. As regards exempted commodities, originally the Central Empowered Committee communicated a list of 36 commodities. In that list, some of the important items now exempted from tax under TNGST Act were not included. Subsequently, responding to our request, the Empowered Committee sent an additional list of 46 commodities, out of which the States were authorised to select only 10 items. Thus certain specific items relating to Tamil Nadu were left out. We have concern that some of these items exempted under TNGST will now have to be taxed under the VAT system either at 4% or at 12.5%. As the Empowered Committee by a majority decision has limited the list of exempted items to just 10 items in the additional list of 46 items adopted, several Tamil Nadu specific items which we sought to include in the exempted category could not be included. Even rice which is the staple food of the common man in Tamil Nadu was not included in the exempted category by the Empowered Committee. As we insisted that rice should be included under the exempted category, the Empowered Committee finally agreed in the meeting held in January 2005 that in respect of food grains, the States will be given option of adopting 0% tax, that is tax exemption, for one year only followed by a review.

175. In the Value Added Tax system, since taxation at every stage is only on the value added, set off for the tax paid in the State has to be given. Thus all inputs which have suffered tax in the State will have to be given set off, when the output is taxed. In view of the set off of the tax paid on inputs and the abolition of Additional Sales Tax, Surcharge, Resale Tax, there will be considerable loss of revenue which may be made good partially by the tax on the value added at different stages. Our view is that there will be a significant net loss of revenue in the case of Tamil Nadu consequent on the introduction of Value Added Tax. It is for this reason, the State Government has insisted strongly that a proper compensation formula should be evolved providing complete protection. The Central Government has now indicated that compensation would be provided at 100% in the first year, 75% in the second year and 50% in the third year. Although there is protection in the first year, the revenue loss could be sizeable from the second year onwards. This continues to be a worrisome aspect.

176. In order to protect small dealers from the rigours of book keeping and assessment, the design of the VAT system has been changed to enhance the limit for registration from the present turnover level of Rs.3 lakhs per annum under the TNGST Act to Rs.5 lakhs. By this measure, about 76,000 dealers will be outside the tax net. Even though this will involve a large loss of revenue of Rs.55 crores per annum, this measure has been incorporated in the design to provide relief to small dealers. In addition, a compounding scheme by which a dealer can pay tax at 1% on total turnover will be made available to all resellers with a turnover not exceeding Rs.50 lakhs in a year. Under this system, another 74,000 dealers will stand to benefit. Thus the smaller dealers will be given a simplified system under the Value Added Tax system. In addition, a facility of self-assessment will be made available to all dealers, thus making it much easier to



comply with the tax system. The proposal to have more stringent penal provisions has been dropped and instead provisions similar to that in the TNGST Act will be adopted.

177. In the Value Added Tax system tax credit will be given for goods held as opening stock provided these goods had been purchased in the State within a twelve month period prior to the date of introduction of VAT. Capital goods purchased after the introduction of VAT will also be eligible for input tax credit both in respect of manufacturers and traders and set off will be available for the local tax and CST paid on sales. Refund will be a specific feature in the Value Added Tax system including refund of excess input tax credit.

178. I have explained the main features of the Value Added Tax system as it is a major tax reform and it is necessary to build a proper consensus among all sections of the society. We also have to consider the fact that our neighbouring States namely Kerala, Karnataka, Andhra Pradesh and the Union Territory of Pondichery have gone ahead with the implementation of the State VAT system. Even though in the Governor's address an intention to commence the State Value Added Tax system from 1.4.2005 has been stated, it is still essential that we carry with us all sections of traders, small businesses, manufacturing sector and consumers in Tamil Nadu in this major tax reform with far reaching implications.

179. Further the State Value Added Tax is a replacement of the Sales Tax which is well within the domain of the State. A duty is cast on this Government to establish a broad consensus within the State if this system is to be introduced. I have set out the main features of the proposed State Value Added Tax system. It will be our endeavour to reach such a consensus and only thereafter proceed with the introduction of a Bill to implement State Value Added Tax. Hon'ble Members of the House will

greatly facilitate this effort if the general debate on the Budget can focus on all aspects of the proposed State Value Added Tax.

### **Other Taxes**

180. Independent Power Projects in the State are utilising Low Sulphur Heavy Stock (LSHS) in the generation of electricity for sale to Tamil Nadu Electricity Board. The rate of entry tax on this item is 16% under the Tamil Nadu Tax on Entry of Goods Act, 2001 with effect from 1.12.2001. This tax has to be ultimately borne by the Tamil Nadu Electricity Board which purchases electricity from these Power Projects. This increases the purchase cost of energy and imposes a financial burden on the Tamil Nadu Electricity Board. In order to reduce the impact of this tax, the rate was reduced to 3% from 16% for a period of one year from 1.4.2002 to 31.3.2003. It is now proposed to continue this lower rate of entry tax at 3% on Low Sulphur Heavy Stock (LSHS) from 1.4.2003 onwards.

181. Banks lend loans by securing properties. At times, these loans are not repaid properly and the properties secured become Non-Performing Assets (NPAs). In order to reconstruct these non-performing assets, the Government of India has enacted the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, which enables transfer of these Non-Performing Assets to Asset Reconstruction Companies. This transfer attracts 6% stamp duty in Tamil Nadu. Due to this higher rate of stamp duty, such deeds are not coming up for registration in Tamil Nadu. In order to encourage such registrations in the State bringing in revenue, the rate of stamp duty on such transactions will be lowered to 0.1% with a monetary cap of Rs.1 lakh. Likewise the rate of registration fee will be reduced to 0.1% and with a monetary cap of Rs.20,000/-.