safe eCollege Getway To The Securities Market
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SAFE UPDATE - KEEP INFORMED

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Editor : CA. Lalit mohan Agrawal

Congratulation: Chandra Das, Income Tax Officer

1 BUDGET FOR 2007-08

Budgeting with cautions

Finance bill 2007-08: The Lok Sabha on 4th of May completed the budgetary process with the passage of the Finance Bill 2007-08 containing the tax proposals for the current fiscal. The Bill was passed with changes which provide relief to several sections. The Bill now is placed before the Rajya Sabha for approval. Mr Chidambaram, however, declined to entertain requests for more sops on personal income and corporate taxes, saying every taxpayer has been given considerable relief.

1.1 GDP Growth Story

The biggest plus is that the growth rate of GDP has improved from 7.5 per cent in 2004-05 to 9 per cent (Quick Estimate) in 2005-06 and, according to Advance Estimate, to 9.2 per cent in 2006-07. The average growth rate in the three years of the UPA Government is, therefore, 8.6 per cent. Thanks to this impressive performance, despite the poor start in 2002-03, the growth target set for the Tenth Plan of 8 per cent will be nearly achieved.

Manufacturing is the main driver of growth and this augurs well for the future**.** In the three years of UPA Government, the growth rate in manufacturing has accelerated from 8.7 per cent to 9.1 per cent and further to 11.3 per cent. The services sector continues to maintain impressive growth and has recorded, in the three years, a growth rate of 9.6 per cent, 9.8 per cent and 11.2 per cent respectively

The agriculture sector has witnessed sharp ups and downs. Average growth during the 10th Plan period is estimated at 2.3 %, which is below the desired level of 4 % a year. About 115 million families are classified as farming families. Furthermore, a country with a large population has to be nearly self-sufficient in essential food items; otherwise supply constraints could upset macro economic stability and growth prospects. Hence, agriculture must top the agenda of the policy maker and must hold the first charge on our resources.

Eleventh five year plan

The year 2007-08 will mark the beginning of the 11th Plan. The objective is faster and more inclusive growth. On the eve of the 11th Plan, the economy is in a stronger position than ever before. The 11th plan has emphasised on the need for large investments in infrastructure and development through PPP route

The Approach Paper to the Eleventh Plan

- ✓ A sustainable growth trajectory of approx 10 per cent by the end of its period;
- ✓ A growth of 4 per cent in the agriculture sector;
- ✓ Faster employment creation & reducing disparities across regions; and
- ✓ Ensuring basic physical infrastructure as well as health and education services to all.

1.2 Security markets

Short selling

The Budget proposed steps aimed at beefing up the stock market infrastructure including the introduction of “short selling settled by delivery, and securities lending and borrowing to facilitate delivery by institutions”. The board of Sebi has approved exactly on the line of the statement contained in the Budget.

1.3 Mutual Fund

Infrastructure mutual funds

The Union Budget proposed that the mutual funds could play a big role in infrastructure development by launching and operating dedicated infrastructure funds. The proposal to launch dedicated infrastructure funds is likely to permit the funds houses to invest directly into infrastructure projects. Asset management companies have already launched diversified as well as sector specific infrastructure funds. But these schemes invested through equities and were not permitted to invest directly into projects.

MFs for overseas instruments

The area where useful work is proposed is to: ‘converge’ the regulations that allow dedicated mutual funds to invest outside the country. The dedicated mutual funds will provide a platform to individual investors who want to invest in overseas instruments. Although the $50,000 limit for individuals investing overseas existed, there hadn’t been too many takers given the complexity of investing overseas.

1.4 Sole identification number

The finance minister proposed to make the **PAN** as the sole identification number for all transactions in the securities market. The only addition to the PAN would be an alpha-numeric prefix or suffix to distinguish different kind of investments. The Budget speech has given much relief to hapless market participants by promising that the PAN will be the sole identification number.

The challenge now, of course, is that of putting MAPIN-quality biometrics into the PAN card, so as to prevent one individual from controlling multiple PAN cards. Investors will now have to quote PAN for all financial transactions, irrespective of the quantum of investment. At present, quoting PAN is mandatory for investments of Rs 50,000 and above in the mutual funds and IPOs

1.5 Small Scale Industries

Incentives for SSI sector

The Budget announced incentives for SSI sector. These benefits will help the SSI, both in short and long term. The country has 24 lakh registered SSI units, while in unorganized sector; the numbers could be five times higher. The organized SSI sector employs more than 29 million people.

- A unit is classified as a SSI, if the maximum investment in the plant is Rs 5 crore.
- The sop is to raise the exemption limit for Excise Duties from Rs 1 crore to Rs 1.5 crore.
- Besides, SSI will also benefit from the removal of Surcharge of 10% on normal Income Tax on all firms and companies with a taxable income of Rs 1 crore or less. (However the surcharge will be levied on fringe benefit tax).

1.6 India Inc

New definition of India: *Under the existing provisions; India is deemed to include the Union territories of Dadra and Nagar Haveli, Goa, Daman and Diu, and Pondicherry. With a view to provide a comprehensive definition of India, it is proposed to define "India" to mean the territory of India as referred to in article 1 of the Constitution, its territorial waters, seabed and subsoil underlying such waters, continental shelf, exclusive economic zone or any other maritime zone as referred to in the Territorial Waters, Continent shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976 and the air space above its territory and territorial waters.*

All companies must contribute to tax

MAT was introduced for the first time in 1996-97 to bring zero tax companies under tax net. Section 115JB provides that in case of all companies, if the tax payable on the total income as computed under IT Act is less than 10% of its Book Profit (BP), such BP shall be deemed to be the total income and tax payable would be 10% of such BP.

BP for this purpose will be net profit increased by the expenses relatable to any income referred to in section 10A or 10B and reduced by the income referred to in section 10A or 10B. Thus, the net profit of the software business eligible for exemption u/s 10A or 10B is to be excluded for MAT purpose. This is contrary to the basic principles of MAT which provides that all company must contribute to tax. Accordingly, it is proposed that BP shall not be increased or decreased by the expenses or income of software companies. This is applicable from A.Y. 2008-09.

The income eligible for exemption u/s 10AA is still to be excluded to arrive at the BP and is kept out of MAT. It means that companies housed in SEZ are not liable to MAT. The large IT companies doing overseas business like Infosys, Wipro, TCS, etc., will get set-off of the foreign tax paid on business done outside India against MAT under a Double Tax Avoidance Treaty. Besides the companies can take credit for MAT paid against their normal income tax liability in the subsequent five years.

Amalgamation & Demerger

The FM proposed that any company undergoing an amalgamation or demerger after March 31 will not be able to enjoy the tax holiday. Also It would soon become mandatory for corporate to notify the Competition Controller of India (CCI) about the mega merger they go for or face a heavy penalty.

Domestic venture capital funds (VCFs)

VCFs invest in unlisted firms or start-ups; called venture capital undertakings (VCUs). Venture funds registered with Sebi enjoy tax exemption on income earned from these investments. Also once registered with Sebi, venture funds were able to exit VCU immediately on going public - provided they had invested a year before the VCU filed for IPO. It is said that the government has reports of misuse of these benefits by several funds. The government has now proposed to limit tax benefits to investments made by venture funds in nine select sectors from April 1, 2007. VCFs which have invested in sectors other than those specified in the finance bill 2007 will cease to enjoy a tax exemption on income that accrues to them from these investments after April 1, 2007.

VC investment in assorted infrastructure sectors, excluding power and telecom, will get the benefit of tax pass-through – Refusing to bow down to extend pass-through tax exemption to all venture capital funds, Mr Chidambaram sought to give some relief to infrastructure VCFs. Along with eight sectors, infrastructure VCFs will also be able to avail of the exemption under which while the fund itself does not pay income tax but its investors have to pay.

1.7 Income tax rates

The exemption limit is being raised by Rs 10,000 to Rs 1, 10,000. The exemption limit for women has been raised from 1, 35,000 to Rs 1, 45,000, while for senior citizens (above 65 years) it has been raised from Rs 1, 85,000 to Rs 1, 95,000.

Education & Higher education surcharge

The education cess is being raised from 2 per cent to 3 per cent across the board. Also the finance minister has left the surcharge of 10 per cent unchanged for individuals earning incomes over Rs 10 lakh a year**.** Taxpayers in the lower slabs benefit as the limit is raised, those in the higher tax bracket will be shelling out taxes at a higher rate.

Existing Tax breaks: Tax breaks on home loans have been left intact, individuals can avail themselves of those benefits – an amount of up to Rs 1.5 lakh paid as interest on home loan is eligible for a deduction from income. The benefit under Section 80C up to Rs 1 lakh remains untouched so taxpayers can continue to avail themselves of those benefits, by investing in products that are eligible.

Medical insurance premium: If you are worried about rising medical costs and think you need to have a higher insurance, then the finance minister's proposal to increase the limit of the medical insurance premium will come handy**.** The medical insurance premium limit, which is eligible for deduction under section 80D has been raised from the present R 10,000 to Rs 15,000; and for senior citizens, this limit has been raised to Rs 20,000**.** Thus, taxpayers will be able to have a larger amount of medical insurance for themselves and their dependents**.**

1.8 Capital gain tax on personal effects

Under the existing provisions; personal effects held for personal use by the assessee are excluded from the ambit of definition of capital assets. Presently, the only asset which is in the nature of personal effects, but is included in the definition of capital assets is jewellery. It is proposed to also exclude from the meaning of personal effects - archaeological collection, drawings, paintings, sculptures, or any work of art. Transfer of such personal effects will attract capital gain tax. (Effective from A.Y. 2008-09)

Artful evasion of tax: The Finance Minister proposed a capital gains tax on profits made by investors from the sale of art work that they own. The government has started tightening the noose on players in this market. The IT department went ahead with searches on a couple of auction houses and art galleries in Delhi and Mumbai for alleged tax evasion. The information that the tax department has so far gathered that payment are being made in cash to several art dealers, simply put, art trading is being used to launder money; art galleries are transacting amongst themselves to push up prices; and many high net-worth individuals are investing in **art-funds.**

1.9 Fringe benefit tax

Employer to pay FBT on Esops

The stock market rally has turned company promoters into billionaires, but employees have benefited too as their stock options have multiplied in value. Esops are equity instruments, issued to employees for no cost or lower cost than the market price.

Until now, no tax is payable on exercising of option by the employees, but capital gain tax, whether short term or long term (exempted, if STT paid) is payable on the gain (Sale consideration – Cost). Thus tax liability is deferred till the gain is realised. Now it is sought to include Esops in Fringe Benefit (FB). The value of FB will be the difference between the fair market value (FMV) of the ESOP on the date of exercise of option and the amount actually paid by or recovered from the employee in respect of it. The board shall prescribe the method of determining FMV.

Thus, FBT @ 33.99% (30% + SC 10% + ES 3%) will be payable on FB (FMV – Cost) by the **employer** at the time of exercise of option. And capital gain tax, whether short term or long term (exempted, if STT paid) is payable by **employee** on the gain (Sale consideration **– FMV considered for FBT**). It seems, the option already given but not exercised will also attract FBT when the option is exercised after 1-4-2007.

The FBT on Esops is here to stay, albeit in a modified version – The much criticised FBT on Esops will stay, but employers can draw relief from the fact that they will now be able to pass on the cost of tax to employees who get these options. Also, FBT will be levied on the value of Esops at the time when it vests with the employee and not when the shares are transferred to him. However, the tax will be leviable only when the ESOP is transferred. This will give marginal relief as the value of the ESOP when it vests with the employee is generally lower than when it is exercised.

ESOPs with transfer of shares beyond March to attract FBT – This could come as a major dampener to all those companies who rushed in with ESOP offers before March 31 to avoid the FBT net. The finance ministry has clarified that FBT would be applicable on all such ESOP offers where the physical transfer of shares have taken place beyond March 31 even though the option may have been exercised by the employee in March itself.

1.10 Dividend distribution tax

More tax on dividends payout

The dividend distribution tax (DDT) is deducted from dividend payable and the net amount is paid to shareholders/ unit holders. It is proposed to increase such rate from 12.5% to 15% on dividend payout by domestic company, and on income distributed by Money Market MF or Liquid Fund whether to individual or to others from 12.5% or 20% respectively to a uniform level of 25%. The DDT on MF was expected to make the flow of funds to bank. *Tax is continued to be not payable on income distributed by Equity Oriented MF.* The dividend so received by the shareholders/ unit holders is not taxable.

Effectively the rate of tax has increased on dividend distribution from 14.025% (12.5+10+2) to 16.995% (15+10+3) and on income distribution by MMMF/LF from 14.025% to 28.325% (25+10+3) for individuals and from 22.44% (20+10+2) to 28.325% for others. For companies still the arbitrage is possible as tax through MF (28.325%) is lower than 33.99% (30+10+3) on the income directly earned by them. But individual's funds will be invested in Bank Fixed Deposits which is the desired result.

1.11 Income tax forms

Mr Chidambaram said the one page form 'Saral' was not very friendly to taxpayers and calling it 'Saral' was euphemism as it had to be accompanied with number of annexure. The series of form is ITR series. These new forms are annexure less and amenable to e-filling. Only return form ITR7 which is for charitable and political organisation has annexures.

New forms notified - The new income tax return forms came into effect from 15/05/07 is a package of eight forms and referred to as ITRs. The new simplified form does not have annexure and the taxpayer will not be required to file any additional papers or certificates except form ITR 7 meant for charitable and political organisation which will have annexures. Salaried individuals who were accustomed to filing in their returns in Form 2D or 'Saral' till last year will now be required to fill in the new form ITR 1. However, unlike 'Saral' which served all categories of individuals, ITR1 can be filled in by only those individuals who derive their income from salary, pension and interest. For income from any other sources, there is a separate ITR depending upon the nature of taxable income for the year.

1.12 Tax deducted at source

Payment to contractors

Finance Bill 2007 proposes to include only such individuals or HUF, whose total sales, gross receipts or turnover from the business or profession carried on exceed the monetary limits specified under clause (a) or clause (b) of Section 44AB during the financial year immediately preceding the financial year in which sum is credited or paid to the account of the contractor.

As per the existing provisions sub-section (1) of Section 194C, deduction of income-tax at source is to be provided from any sum credited or paid to the resident contractor for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor **and** the Government, local authority, statutory corporations, companies, co-operative societies, statutory authorities engaged in providing housing accommodation, etc., registered societies, trusts, universities and firms. The rate of TDS is 1% in respect of advertising contracts and 2% in other cases.

The amendment proposes that the provisions of the said sub-section (1) shall not apply in respect of payments made to contractor by any individual or a member of HUF exclusively for their personal purposes. The aforesaid amendment will take effect from 1st June, 2007.

Rental income from machinery or plant or equipment: 10% (Earlier 15%)

Section 194-I provides for deduction of tax at source by the person paying any income by way of rent to a resident. The existing rate of deduction of tax is 15% if the payee is an individual or a HUF and 20% in case of other payees. However, individuals and HUF having their turnover below the limits specified in clause (a) or clause (b) of section 44AB are not required to deduct tax under this provision. The existing definition of "Rent" as amended by the Taxation Laws (Amendment) Act, 2006 has come into force from 13th July, 2006 and in this definition rent on three new items, viz, machinery, plant and equipment have been inserted and made subject to TDS. However, no separate rate of TDS was notified on these three new items. Accordingly, Finance Bill proposes to separately specify the rate of deduction of tax at source at a lower rate of 10% in respect of any income payable by way of rent for the use of any machinery or plant or equipment and this amendment will take effect from 1st July, 2007.

Interest from banks, post office

The existing provisions of Section 194A provide that deduction of tax at source shall not be made in the case where the amount of interest other than "Interest on securities" does not exceed Rs 5000. The Finance Bill has proposed that the limit for deduction of tax at source shall be Rs 10,000 where the payer is a banking company or a cooperative society engaged in carrying on the business of banking or a Post Office in respect of notified scheme. However, in any other cases, the threshold limit shall be the same, i.e. Rs 5,000. The aforesaid amendment will take effect from 1st June, 2007.

Professional fee: 10% (Earlier 5%)

As per the existing provisions, a specified person is required to deduct an amount equal to 5% of any sum payable to a resident by way of fees for professional services or fees for technical services. The Finance Bill, 2007 proposes to specify a higher rate of 10% for TDS under section 194J. This amendment will take effect from 1st June, 2007 onwards.

A body blow to a host of self employed professionals: According to the amended Section 194J of the Income Tax Act, 1961, if the fee for professional or technical service contract undertaken by any of these professionals is more than Rs 20,000, the contract awardees will have to deduct at the rate of 10%. The provision covers lawyers, engineers, doctors, architects, interior decorators, accountants and those working in areas of advertising and broadcasting. A higher rate of TDS will mean that they will first pay higher tax then claim tax refund at the end of the year. This could create cash flow and working capital problems for professionals, a large number of whom operate on low capital.

Commission or brokerage: 10% (Earlier 5%)

The Finance Bill has proposed to enhance the rate of TDS from 5% to 10% on the ground that many cases have come to the notice where tax incidence in the case of recipient of commission or brokerage is much higher than the amount of tax collected at the rate of 5% and this has been resulting in either deferment in collecting of taxes or escapement of income in some cases. (Section 194H and the amendments will take effect from 1st June, 2007.

1.13 Service Tax

Seven new services under tax net from June 1 - Cost of commercial renting as also a host of other services such as designing, works contract, mining of minerals, oil or gas, asset management and telecommunication is set to go up from June 1. The government notified levy of service tax on these services that were brought under tax net this Budget.

Service tax basic exemption

The threshold level of service tax exemption for small service providers has been increased from the present level of Rs 4 lakh to Rs 8 lakh with effect from 01.04.2007. The exemption is available if the aggregate value of taxable service rendered by a provider of taxable service from one or more premises does not exceed Rs 8 lakh in the preceding financial year.

Thus, if the value of taxable services rendered (not the actual realisation) in the preceding financial year (say 2006-07) exceeds Rs 8 lakh, the exemption in the next financial year (i.e., 2007-08) is not available. Consequently, the limit for obtaining service tax registration has been increased from Rs 3 to Rs 7 lakh.

Rate of Service tax

Although, finance minister did not tinker with the service tax rate, which is 12 per cent at present; an additional cess of 1 per cent for secondary and higher education, in addition to the existing education cess of 2 per cent, has been levied on the total service tax rate. This takes the total service tax incidence to 12.36 per cent. Another seven services have been bought under the service tax net this year, taking the total number of services that are taxable to 106.

Rent from commercial properties

The government has also proposed to bring commercial property rentals under the service tax net. This means property owner will now face service tax. These owners will now have to be register with the Central Excise and have to pay service tax, if rent from such properties is more than Rs 8 lakh pa.

The government has, however, given marginal relief for renting services. Property tax paid on immovable property is specifically excluded from the levy of service tax. This means that, service tax payable on the rental amount received minus the actual amount of service tax paid.

Asset management

The government has also proposed to bring in asset management services run by individuals under the service tax net. This means portfolio managers, who provide investment fund management advisory services, will now face service tax. These managers will now have to be register with the Central Excise department and have to pay service tax, if their service fee is more than Rs 8 lakh per annum.

MFs would not be loaded with service tax - The Central Board of Excise &Customs (CBEC) has said the entry load and exit load charged from investors by mutual funds should not attract a service tax. The decision has arrived at after a judgment passed by the Central Excise and Service Tax Tribunal held that service tax cannot be levied on entry and exit load charged by mutual funds.

1.14 Peak Custom duty: 10% (Earlier 12.5%)

Taking step forwards aligning Customs duties to Asean (Association of South East Asian Nations) levels, which range between 5 to 7.5 per cent; finance minister reduced peak Customs duties to 10 per cent from the present level of 12.5 per cent. The new peak rates are in tune with the industry's expectation. Experts feel the duty reduction will make the Indian industry more competitive in the global arena.

Effective rate of Import Duty: The effective import duty rate, factoring in the 16 per cent countervailing duty and 4 per cent special additional duty and education cess will come down from 36.73 per cent to 33.85 per cent. Thus after adding all additional duties, the customs duties on finished products will come down; this is good news for the user companies.

1.15 Banking Sector

Mortgage guarantee companies

The government proposes to create a regulatory framework for setting up mortgage guarantee companies, for providing insurance cover to home loan companies. Banks and housing finance companies that lend against mortgage would have greater comfort if the mortgage can be guaranteed through a three-way contract between the borrower, the lender and the guarantor. Mortgage guarantee is a critical component in a residential mortgage financing. The home loans market has been growing at a breath-taking pace over the last couple of years. And with the growth, banks have also been facing higher levels of bad loans. Housing finance players have welcomed the move saying it will enable them to penetrate further and also profile of the borrower – identify people with a terrible credit history and a series of defaults. And if there is backing, segments such as self-employed people, unorganized sector workers and the poor will benefit as the lender will be protected against default.

1.16 Banking cash transaction tax: No levy upto 50,000/- (Earlier 25,000/-)

FM had added Chapter VII in the Finance Act, 2005 dealing with Banking Cash Transaction Tax (BCTT) and levied a tax on withdrawal of cash (other than from a Saving Bank Account) and on encashment of one or more term deposit, whether on maturity or otherwise, on a single day over Rs 25,000 by individual or HUF or Rs 1, 00,000 by other person from Scheduled Bank @ 0.1%. Thus a person withdrawing Rs 25,000 in cash would have to pay a small sum of Rs 25 as BCTT. Now, the FM proposes the limit of Rs 25000 per day to increase to Rs 50,000 to reduce the hardship in genuine cases. The finance minister seems to be convinced that BCTT is an effective anti-tax-evasion measure by continuing with it.

1.17 Reverse mortgage for senior citizens

The National Housing Bank (NHB) will shortly introduce a novel product for senior citizens: a '**reverse mortgage**' under which a senior citizen who is the owner of a house can avail of a monthly stream of loan, while occupying the house, without repayment or servicing of the loan. Reverse mortgage will enable senior citizens to mortgage their property with bank/ finance company.

Senior citizen, owns his home, but pressed for cash? Until February 28, 2007, he had two options to get cash from his home: sell it and move out or borrow against it and make monthly repayments. But, Union Budget 2007-08 has made a proposal, giving him a new option of using his home as a source of income, without any requirement of making monthly repayments. A reverse mortgage essentially converts the home equity into cash, which can be put into varied usages, without any requirement to make monthly repayments. Some features of such loans are:

- The borrower does not require an income to qualify for the loan.
- The credit history of the borrower is not verified.
- The loan amount depends on the borrower age, value of the property, and rate of interest.
- No repayment required till the borrower or any of the co-owner (spouse) occupies the property.

The older a homeowner, the more the amount he will be able to raise by offering his home for reverse mortgage. The draft guidelines issued by the apex housing finance regulator, NHB, says that the loan can be for a maximum tenure of 15 years and those in the age bracket of 60 to 70 can be eligible for 45% of the value of the property pledged with the lender. While for those in the age bracket of 71 to 75, it is 50%, between 76 to 80 years it is pegged at 55% and above 80 years is 60%. However, the lending institution can decide the eligibility quantum of the loan. Also, the lending institution will be required to revalue the property mortgaged at least once in five years and based on revaluation the loan amount can change.

The guidelines say that the product can not be provided for speculative or trading purpose. Also, commercial property will not be eligible for being pledged under the reverse mortgage scheme.

Under the scheme, senior citizen can consider earning a monthly income by pledging their home with the HFC or a bank even while they continue to occupy it for life time. The borrower is not required to service the loan during his life-time. Married couples will be eligible to jointly borrow provided both are above 60. Also there should be a clear title indicating the prospective borrower's ownership of the property. The borrower will have option to prepay the loan any time during the tenure while the lender can choose to waive the penalty charges.

Regarding the settlement of the loan, NHB has said that the loan shall become due and payable only when the last surviving borrower dies or would like to sell the home, or permanently moves out the home for aged care to an institution or to relatives. Typically, a 'permanent move' may generally mean that neither the borrower nor any other co-borrower has lived in the house continuously for one year or do not intend to live continuously.

On the borrower's death or the borrower leaving the house permanently, the lender would settle the loan with accumulated interest from the proceeds received from the sale of residential property. Lenders should provide two months from the time reverse mortgage repayment is triggered for house to be sold. The balance surplus (if any) remaining after settlement of the loan with accrues interest shall be passed on to the estate of the borrower. Alternatively, the borrower or his/her heir can repay the loan with accumulated interest and have the mortgage released without resorting to sale of the property.'

1.18 DMO is a good step forward

Perhaps the most important announcement of the budget speech, in terms of long term structural economic reforms, is the establishment of an independent debt management office (DMO). Indian debt management has inherent weaknesses, since there is no one a place in the country where there is a full database of all the liabilities of Government of India (GoI). So there is a need of an independent DMO. As far as the mechanics of the implementation are concerned, the Budget speech says: "In the first phase, a Middle Office will be set up." A middle office would constitute a single comprehensive database about all liabilities and guarantees of GoI, and a risk management overlay, which improves the risk profile of the overall portfolio. .

Besides, India has burdened the RBI with the task of being the **investment banker** to the government, together with **regulator of monetary policy and regulators of banks,** both having conflict of interest. As an investment banker RBI is selling bonds for the government. If the RBI tries to do a good job as investment banker, which involves selling bonds at high prices and induces banks to buy long-dated government bonds, then it leads to hurt the safety and soundness of banks in India.

A not so fair game: *Despite high call rates of 60-70%, banks bid aggressively at the 180 and 91-day T-bill auctions. It will be logical for banks to try and exploit the higher rates, rather than tie up the money for 91 days at 7.97%. The lower cost of government borrowing seems to be coming at the expense of higher borrowing costs for other borrowing classes. This has been caused by the requirement of SLR by banks. Banks are required to maintain close to 25% of their liabilities in government securities as statutory liquidity requirements. The recent uptrend in deposit growth is placing further pressure on banks to meet SLR requirements.*

2.1 SECURITY MARKET

1. Investors have no business investing in rupee stocks

Rupees stocks are stocks that are trading at less than Rs 10 and their market price hovers between one paisa and Rs 9.99. Investors should exercise more caution before investing in rupee stocks. Why are so many investors getting into rupee stocks? The answer is that Indian mindset revolves around something that is cheaper. The logic is that the amount being lost is low and an investor can buy large quantities. Also the stock is more likely to double.

Why it makes sense to stay away?

- These are not static stocks and keep moving around. Like most speculative stories, there's hardly any fundamental reason for these shares to move up.

- Rupee stocks are illiquid and prone to manipulation. In most cases, investors would be the last ones left standing in the stock.

- Further, it's also not the case that rupee stocks can give fabulous returns. If a stock is quoting at a very low price point, say Rs 1 then even a large movement, say 25% will be an upside of just 25 paisa.

- There is little to suggest that any investor could have an outlook while investing in rupee stocks. So the lesson is simple that retail investors have no business investing in rupee stock.

2. Intra-day traders

Ever since the stock market has started, it has always behaved in volatile manner. One of the classes of traders who have started gaining out uncertainties is the intra-day traders, who choose out stocks that in the thick of action. Intra-day traders trade in such stocks in large quantities on wafer thin margins. However, these traders keep changing their loyalties on these stocks, which depend on the triggers in any stock, and that stock should be in huge demand at any time. One of the classic examples amongst such stocks, continuously inviting bulk activities for over past two months now, is IFCI:

1. The trigger in the stock was initially set by the company, close to four months back, when it decided to offload 7% stake of NSE, to a consortium of FIIs. Since, then a few other triggers have come on the IFCI counter that strategic partners have shown interest in buying out a stake in IFCI. Apart from same, IFCI sits on couple of assets (including huge pie of land) of some borrowers, which had earlier defaulted in repayments to IFCI. The stock has been inviting continuous buying interest from long and short term investors and has already appreciated over 150%.

2. The volume in the cash segment very from at least five crore shares to ten crore shares. Traders with interest in bulk activity have not hesitated to participate on a regular basis on this counter on NSE.

3. The records from NSE for past three months suggest that on a daily basis an average of 30 to 40 % volumes in cash segment are logged by a handful of traders/brokers, who enter and exit from the stock on margins varying 2 paisa to 8 paisa, on different days.

All that they need to do is keep a buffet stock of IFCI in hand, to ensure that they may even leave delivery of IFCI on days in which they may have short sold earlier, and may not have been able to buy at a lower price later in the day.

Reliance set to engineer L&T rival

In 1988, Reliance Industries made a determined bid to take over Larson & Tourbo, the country's premier engineering and infrastructure behemoth. But a fierce battle triggered by then finance minister VP Singh and Indian Express Group forced Reliance to retreat – one of the rare occasions when the one of country's most successful entrepreneurs Dhirubhai Ambani had to accept defeat.

Nearly, two decades latter, Reliance chairman Mukesh Ambani is now set to revive his father's plans to build an engineering, procurement & construction services (EPC) powerhouse, modeled on the same lines as one of L&T core business.

The blueprint for a separate global EPC business – which will bid for infrastructure projects within the country and abroad – has been on the drawing board for nearly two years. But now, the building blocks are finally falling in place. Like every project – be it retail or upstream exploration – that Mr Ambani dreams up, this one too is gigantic. Reliance plans to execute its own projects as well as build bridges, highways, dams, power projects, airports, chemical plants and refineries initially within the country and subsequently in the Middle-East and the US.

When the plans was first mooted last year, building the mega refinery at Jamnagar became the dominant priority – and the task of building the competencies for a separate EPC play receded to the back ground.

In a small way, Reliance has already testing the concept in the US through an initiative called Crest with US major Chevron. Across the western world and the Middle East, almost all major petrochemical and refinery projects are running behind schedules, thereby leading to huge cost overruns. The reason: an alarming shortage of engineering talent. The idea behind the Chevron tie-up was to leverage Reliance's engineering design skills to ensure these projects can be completed on time.

Much like L&T, which inked joint ventures for separate verticals with global majors such as Chiyoda of Japan and US-based Sargent and Lundy, Reliance too is eyeing JVs to bring in global best practices on engineering process automation.

Mr Ambani sees it; the new plan is predicted on the country's strength as a high-quality, low cost destination for global EPC services. But building overseas projects using engineering talent is easier said than done. One, tighter local immigration rules, among other things, will make it more difficult to send large teams of Indian workers to build dams and airports. So, Reliance is examining the option of a unique onsite offshoring model.

For instance, if it takes up the task of refurbishing many of the old refineries in the West – and there are hundreds of such plants which experts describe as 'paint held together by rust' – Reliance will look at sending small teams of engineers for either the finishing touches or testing and interconnecting, but bring back much of the fabrication work to its SEZ at Jamnagar, where it can modularise the construction at a relatively lower cost. Even if one were to add the cost of freight, there could be sizable cost savings for EPC projects in the Middle East.

Of course, the business model faces a huge challenge. The attrition rate is high among engineers. Already, many of those working for the $ 6-billion Jamnagar Export Refinery Projects are getting snapped up by other Indian and international firms.

It's a difficult challenge to retain them. We try up best to retain talent up to certain limit. Beyond that, we let them go. Engineers who stay till the completion of the refinery project will get big money as part of their Esops.

Even hiring engineers at the entry-level isn't easy. Most engineers are taking up jobs in the financial, consulting services, and IT sectors because they pay more than double that of any engineering firm. So how does Reliance hope to cope with the staffing challenge?

There are three routes that Reliance will take to staff its EPC business:

- One, it hopes to initially get a pool of experienced people through its collaborators.
- Two, it plans to offer an option to many of its experienced mid-career engineers in its operations, maintenance and technical functions, who want to seek a change.
- Three, it plans to continue hiring 700-800 engineers every year from engineering colleges across the country.

What it means for RIL

There are very sound reasons why Mr Ambani is excited by the opportunity of building an engineering services business. At one level, this enables him to harness Reliance's core competency of building large-scale projects at an aggressive pace and cost and institutionalise it for the future.

For instance, when the Jamnagar project ends, Reliance will be able to put its engineers onto a new project, and thereby not lose them. Second, when Reliance continues to execute many of its multibillion dollar project, it will not have to face serious quality and time delays that tend to take place now.

There's another critical reason, and it is linked to reliance's newfound accent on partnership and inorganic growth. In the global M&A game, as Reliance see it, having a robust EPC business is likely to be seen as a differentiator. Across the developed world, there is a huge shortage of engineering talent. So a partner who brings in critical resources – the availability of low-cost, high-quality engineering skills – to the table will gain the upper hand over, say private equity firms.

2.3 FOREIGN FINANCIAL INSTITUTIONS

Negative on India

Big FIIs and hedge funds seems to be negative on India in the short term as the stock prices are adjusting to high inflation and rising interest rate. Various other reasons which have a bearing on their sentiments of foreign institutions or others abroad are given below -

1. More tax on corporates

Contrary to the expectations; the finance minister has introduced an additional 1% cess across the board, MAT on software companies etc. If the budget was a disappointment, things could go worse further. It is looked a bit contradictory by FIIs that government wants to build infrastructure and it is increasing taxes on real estate, construction and cement. Prime minister said: "It's a trade off between growth and inflation". However, FIIs are not too happy about this trade-off.

2. Retrospective tax amendments

It is to be ensured that the various policies regarding the nature of taxation system is consistent over a period of time. However, the Budget document shows that nearly every fourth amendment seems to be retrospective in nature. These steps will only dent the confidence in the tax system because it signals changing the rules of the game mid-way. Some of these steps unveiled by the government may cause more damage to its reform image than anything else. For overseas investors who expect a stable environment on the tax front, such changes at regular intervals come as a rude shock. What's more damaging is growing feeling that the government is all set to collect taxes by any means.

3. Liquidity of yen carries trade suddenly dried

Yen carry trade is the practice of borrowing in yen and deploying it in high yielding assets. The liquidity created by yen carry trade that was flooding global equity markets seems to have gone dry all of a sudden.

4. More taxes proposed on multinationals in china

In China domestic firms pay income-tax of 33%, while most foreign-funded manufacturing enterprises pay 15- 24%. China has offered preferential tax treatment to foreign firms since the early 1990s. Chinese economists have complained that the rules give multinational companies an unfair advantage and encourage disguised capital flows that find their way to China to take advantage of the tax breaks. China's parliament passed a law that will unify tax rates for local and foreign companies. If the new tax law which is implemented in 2008 will force most foreign-invested companies to pay 25% of their income. The 25% tax rate will also apply to local companies, which have so far paid 33% income tax, although many of them have benefited from special arrangements and exemptions. It is argued that unifying tax regime will help to create a fair competition in tax-collection; transform the mode of growth; coordinated regional development and raise the quality and level of our country's use of foreign investment.

5. Domestic corporate bond market is more attractive

FIIs are turning into significant investors in the domestic corporate bond market. The surge of FII inflows in debt attribute to the fact that short term rates have been on an upward trajectory. For instance, corporate bonds with a one-year tenor currently offer a yield in the range of 10.50-10.75%. Even on a fully-hedged basis; FIIs stand to earn a spread of over 250 basis points over the London Inter-bank Offer Rate (Libor).

2.4 WARNING SIGNALS

The periods of relative stagnation

1. The historical fact

In the recent years, the GDP growth has been accelerated by investment-led demand in sectors like capital goods, cement, metals, commercial vehicles, construction and engineering, which have had a dream run so far. However, the history tells that the periods of high gross domestic capital formation (GDCF) were followed by a period of relative stagnation in the public sector. The historical fact may come true for private sector too

2. Public sector may stop feeding growth

Besides, recently the public sector turned into a net severs from being a net spender earlier. Public sector's saving accounted for 6.2% of national gross savings in '05-06. This development has clearly gone in favour of the private sector. However, Inflows from public sector may not contribute to the same extent the growth of private sector in future

3. Investment puts pressure on interest rate

The current investment boom was preceded by savings glut; for three years between FY02 and FY04, gross savings exceeded gross investment in the economy. Simply, we can say that there was sufficient money to invest in these projects, without pushing up interest rate. However, in FY05, GDCF began to exceed domestic savings. This has put pressure on the domestic interest rate. The double digit growth along with high interest rates seems far too optimistic.

4. Inflation lowers consumption spending

Despite a number of measures, inflation continues to remain around 6%. Higher inflation rate not only raises the risk of a further liquidity tightening by RBI, it also cuts the purchasing power of consumer, lowering consumption spending in the economy.

5. Politics come back to haunt corporates

First, the industry agreed to roll back steel prices. Next was the turn of the cement industry. Industry agreed to hold prices for the next one year. For a government under siege, the corporates are a small constituency to please.

6. Liquidity-tightening has cascading impact

The liquidity-tightening measures by RBI have had a cascading impact across the financial sector. Monthly Income Plan funds have earned no returns during the month and correction in the stock market has eroded NAV of most MIP funds in the last one month.

7. Rising rupee pinches exporters

The rising rupee is beginning to pinch India's top exporting sectors like IT, textiles and automobiles. The rupee crossed the 43.50 per dollar mark, 19-month high on 21/03/07. Last quarter, the rupee was at 44.10. As of now, it is at 43.50 and as such there is an almost 1 – 1.5% appreciation.

3.1 MUTUAL FUNDS

1. Look at the best risk-adjusted returns

For the investor, investment options are getting complicated by the day. The enormous categories, various asset classes, many product innovations and hundreds of schemes, make the investment process difficult and confusing. It's your hard-earned money, so always look for funds that deliver the best risk-adjusted returns. Start by trying to understand the concept of risk: liquid funds are the schemes with minimum risk; floating rate funds form the next level of risk; balanced funds stand between debt and equity funds; equity funds carries the highest level of risk. So research your investments, remember your goal, re-examine your risk and invest – so that your money can work as hard as you.

2. Trigger Options

Investing for retail investors should be a long term process. However investors have to quit for various reasons. Short term investors can choose a revenue or profitability as an exit target by stepping into the Trigger Options. The investors are required to fill in the relevant forms to activate the triggers of their investments. A big advantage of this facility is that it saves from botheration of keeping track of one's investment. As the name suggest, triggers are options provided to investors to automatically redeem mutual fund units upon happening of a pre-defined event. For instance **Appreciation trigger** automatically redeem the investment once the NAV appreciates to a pre-defined level; **Stop loss trigger** protects the investment from depreciating further after NAV reaches a certain predetermined level; **Date trigger** redeems your investment on a specified date; and **Switch trigger** allows switching from, say equity funds to debt funds once the specified target returns are reached.

3. Multi-manager mutual funds

Different fund houses have different investment styles, and perform differently under different market conditions. So, how can you rely on just one fund manager or a fund house to produce astounding return? After all, just as the very best batsman can play a bad shot and get out for a duck, the greatest investment manager can go through bouts of poor performance. Here's where multi-manager funds score a ton. Multi-manager funds employ the skills of investment managers to manage the assets. A lazy way of looking at such funds would be to describe them as something that bundles the best performing managers into a single fund. Multi-manager funds aim to achieve better long-term returns than a single-manager fund, with less volatility. It is like saying the sum-of-the-parts is greater than the whole.

4. Equity opportunity funds

Opportunities funds are aggressive equity funds that follow an aggressive fund management style as compared to plain vanilla equity funds. Basically, the risk here is taken in two ways: one by having a concentrated portfolio and the other by having higher cash levels. In the case of the concentrated portfolio, the fund manager would invest in fewer sectors or stocks. So, unlike normal equity funds, which diversify stock investments across sectors and a large number of stocks to reduce risk, here the exposure for a single sector would be higher. The idea is to benefit in the short to medium-term from taking larger exposures in select sectors or stocks that might outperform others. So, if the sector or stock under consideration does well, the fund benefits and vice versa. Secondly, in the case of equity opportunities, the fund manager could also get into timing the market. If market values are falling or if there is a dearth of good stocks, the fund managers might just hold higher cash levels. In contrast, a normal equity fund stays invested at all points of time through they may sit on smaller cash levels at times. Higher cash levels on the one hand could protect the fall in NAV values in a bear market, and any rally missed could also mean under-performing the benchmark indices.

3.2 GOLD EXCHANGE TRADED FUND

An exchange traded mutual fund scheme

SEBI gave the green signal to two Indian fund houses – Benchmark Mutual Fund and UTI AMC – to launch Gold Exchange Traded Funds (ETFs). India will be the fifth country in the world to launch Gold ETFs (after Australia, US, UK and South Africa). What this means is that, the investors can now invest in gold just as they do with mutual funds.

A Gold ETF is an exchange-traded mutual fund unit listed and traded on a stock exchange, just like stocks. Gold is the underlying asset for the units of that fund. Every Gold ETF unit represents a definite quantity of pure gold and the traded price of that unit moves in tandem with the price of the metal. The trading in gold ETF is done on a spot basis in electronic form, and the settlement period is T+2 (the day on which trading is done plus two days).

Another advantage is that the gold ETF is a piece of paper that can be dematerialised just like a normal share. In principle, buying gold ETFs is similar to buying securities in the equity market. The benefit is that investors can buy really small quantities – as low one gram of gold.

ETFs aren't suited for those who want to buy for making ornaments or for other manufacturing purposes as the securities cannot be exchanged for the underlying metal. It is meant for investors who wish to diversify their portfolios to minimise risk from external factors. According to the new regulations, gold ETFs will be treated as debt MFs. This means short-term capital gains will be taxed at 30% and the long-term capital gains at 10%.

The custodian will have to get the 99.995 purity gold in his custody and the gold bought will also be insured to secure the value of the ETFs. The valuation is done on the basis of the morning price quoted on the London Bullion Markets Association (LBMA) in US dollars per troy ounce for gold. It will be subject to the adjustment for conversion to metric measures as per standard conversion of US dollars into rupees according to the RBI reference rate declared by the Foreign Exchange Dealers Association of India.

Gold take care of inflation – a definite advantage over most of other asset classes. It has been proven that gold beats inflation by a safe 2%. Regarded as the safest haven, gold is a good inflation hedge. With the dollar in doldrums, many economies are voting in favour of the gold standard. The supply of gold has been declining since the past five years. The launch of ETFs will require almost 600 tonnes of gold and this will convert into a 5% incremental demand each year for the next three years. Fund allocation for the gold as an asset class has risen to 10% from 5%. Though gold peaked to $725 an ounce last year, price doesn't seem to be setting down in the near future. .

Gold Benchmark Exchange Traded Scheme

India's first gold exchange traded fund (ETF), Gold Benchmark Exchange Traded Scheme, debuted on NSE on Monday (19/03/2007) and traded 66,000 units amounting to Rs 6.3 crore. There are about 5,900 trades. The product opened at 942.87 per unit, of a gram. The spreads were good, and price movement was in tandem with global markets.

Currently, authorised participants would be large bullion dealers who can create redeemable gold units, and retail participants would buy gold. Jewelers and traders would enter the market only as day trading participants, after the product becomes liquid.

4. FINANCIAL SECTOR: TRANSFORMING TOMORROW

*INDIA is emerging as a strong destination for the financial services giants from the West like HSBC, Standard Chartered Bank, Fidelity, and Bank of America for setting up **captive centres**. The nature of the work of these outfits is more in the area of KPO. The nature of KPO work done by these captives is more complex and sophisticated like derivatives, options, equity research among others. The work done by the captives are more strategic and are very specific revenue generators.*

1. FINANCIAL ADVISORS:
Weigh impact on investors

A Financial Advisor plays a crucial role by enabling individual investors to access a large range of products, which cater to their diverse needs. The Financial Advisors create and manage customized investment plans to each of their clients. The Financial Advisors in developed markets have easy access to highly advanced technology platforms that enable them to not only meet customers' demands but also add significant value to their financial needs.

2. WEALTH MANAGERS
Map out the details to translate into benefits

Unlisted stocks & securities

Delisted stocks from BSE/NSE and securities listed on the regional stock exchanges are all of a sudden have become attractive. Earlier, this segment was dormant and witnessing no trading. But now the scrip has changed with a flurry of direct offers from broker/traders, who claim that they are willing to buy them out. An interesting trend about these stocks and securities is that the prices have shown fluctuations from time to time. Usually, move to buy out these dormant stocks are either initiated by the promoters. The only flip side, for the investors who want to get rid of such stocks is that since such deals are off-market transactions, they need to pay capital gains tax.

3. FINANCIAL PLANNERS
Value unlocking for investors

FIs be allowed in short sales of equities

Institutional investors, including foreign portfolio investors, mutual funds and insurance firms, are barred from short selling, although there is no such restriction on individual investors. At present, if an institutional investor feels that a certain stock is overpriced, he can sell only if they are in possession of the stocks. Often, market operator ramp up stocks where the institutional holding is low. But if institutions had the facility to borrow those stocks and unload them in the market, manipulation of stock price on the upside would not be so easy. The finance ministry is in favour of allowing short sales in equities market – with the initial kick-off to be restricted to local bank and mutual funds. Thus a mechanism will be established whereby these institutions can borrow stocks from **depositories** to short sell in the cash market. Short selling by institutions will have a stabilizing influence when markets tend to move in extreme, thereby acting as natural speed breakers. Alternatively, if the markets are falling steeply, the same institutions could cover their short positions.

4. INCLUSIVE CEOs

Innovative responses to problems

The next growth engine

In pare 101 of the budget speech, The FM realise the objective of making financial services the next growth engine for India. India has an opportunity to export financial services. The real importance of this runs goes far beyond the immediate export revenue. The most important benefit of an export-quality financial system lies in the opportunity to get higher GDP growth out of the same investment rate.

5. RISK MANAGEMENT CONSULTANTS

Educate – Engineer and Enforce

Indians need better financial literacy to cut risk

Max New York Life – NCAER recently conducted a comprehensive survey of over 63000 Indian households to understand how India earns, spends and saves. Findings broadly confirm the fact that Indian households are in the habit of saving out of household income. However, more than half prefer to save by keeping their surplus income in commercial banks; more than third of Indians simply prefer to keep their surplus money at home; and households opting for post-office deposits account for just 5%. At the same time their awareness of strategic financial planning is at relatively primitive. The survey points to a tremendous need of enhancement of financial literacy and education of households to do better in achieving lasting financial security.

6. MICROFINANCE PROFESSIONALS

Developing alternative credit delivery models

Partnership-lending programme with MFIs

Under this system, MFIs (partners of the bank) disburse loan amounts. While the loans sit on the bank's book. The due diligence, documentation, collection of repayment installments is all handled by MFIs who also share the credit-risk to a small extent. ICICI Bank is the largest lender to MFIs. In March 2006, some of the MFIs in Andhra Pradesh were charged with charging exorbitant interest rates, hidden costs and unethical profits. In a spate of recent guidelines, RBI no longer allows banks to outsource the credit approval process, which under the partnership-lending model was so far being handled by the MFIs or the borrower groups. The central bank also desires that the lending banks should keep detailed KYC records of individual borrowers, the promissory notes and photographs. Such documents, where complied with, were also kept with the MFIs. MFIs are facing cash crunch on RBI whip, as the ICICI Bank stops funding for Microfinance Institutions following RBI's insistence on better Customer Identification.

7. CREDIT COUNSELORS

Resolve convertibility and recompensation issue

Terrorists trading on bourses

Terrorists are not only getting tech-friendly but market-savvy as well. A good part of terror-funds is being sourced from manipulation of the bourses, particularly the Mumbai and Chennai stock exchanges, through fictitious or notional companies.

8. TECH SAVVY PROFESSIONALS

Take first step to ensure efficient and reliable system

National e-governance plan (NeGP)

The NeGP aims at transforming the manual task of registration and clearance issuing of government services into an electronic medium for interaction between government departments and between the government and the citizen. While the NeGP has been initiated by the centre, the implementation of the mission mode projects (MMPs) is decentralized. The MMPs include national ID, central excise, income tax, passport, pensions, banking, and insurance, land records, property registration, transport, agriculture, municipalities, gram panchayats, commercial taxes, treasuries, police and employment exchange. The plan will be implemented over the period of three years.

9. ONE-STOP-SHOPS

Dedicated to offer related services under a roof

Financial Shoppe

Financial Shoppe will provide all the financial services like insurance, mutual fund, debts, bonds & debentures, bank deposits, post office schemes, stocks, paper gold, forex, foreign equity, and new instruments which would form part of financial market. It would help to develop systematic investing to create wealth and will not indulge in speculation.

10. CONTINUING LEARNING CENTRES

Take informed decisions

The role of FIIs in determining the Secondary Markets

The role of the mighty FIIs in determining the direction of the secondary markets may be on the decline, since the FII inflow as a percentage of the total market cap of the sensex companies has fallen over the last three years. While in 2004-05, FII flows were 4.9% of the overall market cap (averaged across 12 months); this figure fell to 4% in 2005-06; and in 2006-07 FII inflows is expected o decline further. Though FII inflows in sensex companies have risen but it has not kept pace with the growth in the market. There may be several reasons –

- FIIs typically take larger exposures in newer markets;
- FIIs have already invested or there is limited free float available in the market;
- The continued bull-run has allowed making good returns and they are now reducing their exposure;
- The pace at which the assets under management of mutual fund industry are growing. While the AUM stood at Rs 1, 39,616 crore in March ’04; it stood Rs 3, 58,233 crore in February ’07;
- In 2006, the capital markets witnessed high levels of activity from alternative financial instruments including private equity (PE) and qualified institutional placements (QIP). High levels of PE and QIP may be contributing to the falling share of FIIs.

11. GLOBAL OUTLOOK

The theory of correlation

The increasing correlation of Indian markets with world markets has made many people rely on the performance of other equity indices to take a call on how the Indian market would perform that day**.** There may be correlation between all open economies. It increases vulnerability to international shocks. It has gone up in the last five years with major economies of the world getting inter-linked.

Correlation is a statistical measure of how much the movement of two indices is related. The range of possible correlation is between –1 and +1:

- +1 means a perfect positive correlation. A positive correlation between the two indices means that they tend to move up and down together;

- A result of -1 means a perfect negative correlation; and

- 0 means no correlation. A zero correlation means that the change in value of one index has no bearing or impact on the change in value of the other.

India's correlation with emerging markets such as Thailand and South Korea appears to be on the wane, while that with developed markets has been on the rise. The correlation has increased for FTSE (London), Bovespa (Brazil), Nikkei (Japan), Dow Jones, NYSE, Nasdaq (US) and CAC40 (France) since 2000.

Indian stocks have moved in tandem to global trends more in bear phase than bull phase; for instance – correlation between Indian and global markets was much higher in the March 2000 – September '01 period (the bear phase triggered by the technology stock crash), than in the subsequent recovery September '02 to March '04. Similar trends played out in '06 as well, with the our market declining in line with global trends during the corrective episodes in May- June '06 and in September- December '06.

12. ISSUES OF THE PRESENT

Freedom to get & fail in the system of free enterprise

Dubai new haven on earth for HNIs

In the last one year, hundreds of high net worth, residents Indians (HNIs) have floated companies in Dubai's free trade zone to either evade tax or stash away piles of unaccounted cash. After the government began tax export earnings, many exporters have been looking for a way to escape the tax. In the Emirates, a foreigner can own 100% in a company only if it's set up in one of the free trading zones. Also, Emirates have a tax treaty with India. **So, a company is formed, fully owned by an Indian consultant,** and the money he makes by advising international clients are parked in Dubai – in a bank account that the new company has opened. The money is tax free in Dubai, but not in India. Though Mauritius has a treaty with India, no Indian can form a company in the Indian Ocean Island and RBI's $ 50,000 window does not permit Indians to put money in Mauritius, along with few other countries like Pakistan and Afghanistan.

The fun is that he can eventually bring the money to India – by either investing in Indian securities or coming in as investor with a private equity player or a venture capital fund, which is investing in India. This is the story when the money earned is legitimate, but the predominant concern is to hide it to escape tax. What is the source of money cannot be explained – say, a kickback from a large international contract or black money generated locally.

The economic survey for the fiscal 2006-07 was laid in Parliament on 27th February, 2007.

Liquidity in the system improved	**Nature of FI flows changing**	**State finances have improved**
FRBM target may be achieved	**Forex reserves: $ 185 billion**	**Warning against fiscal rectitude**

Pointers to the budget

- Modalities for phasing out CST to enable VAT implementation;
- Amendment to existing SEZ policy to steer clear of controversies;
- More measures to integrate rural and agri sector with the organised financial sector;
- Plans to revive corporate debt market by encouraging individual and FII investments;
- Strengthen regulatory aspects to ensure orderly conditions in commodities futures;
- Comprehensive policy for agri & food sectors, which have caused higher inflation;
- Food and petroleum subsidies won't be allowed to derail fiscal consolidation;
- Organised retail and tourism deserve to be boosted.

India is shining

- ✓ The economy is growing at 9.2%;
- ✓ Employment growth has accelerated to 2.5% a year;
- ✓ Fiscal deficit is well under control;
- ✓ Foreign direct investment is surging;
- ✓ The capital markets are shoveling large dollops of money from household savings;
- ✓ The nature of India's growth is shifting from consumption-led to investment-led;
- ✓ Exports are booming;
- ✓ Forex reserves have climbed to a level where they can cover 11 months' imports;
- ✓ Survey sees inflation as a manageable problem.

6. BANKING & SECURITY LAWS

High rates on bulk deposits

The interest rate war waged by banks to lure big deposits has come under government scanner. There is a degree of concern that banks' rush to build balance-sheet, make large loan commitments, and the subsequent effort to mop up deposits, at whatever cost, could endanger their health. The offering of fancy returns on deposits would eventually raise their cost of fund and squeeze spread. The spiraling returns in the bank deposit market are out-stripping the high administered rates earned by the post office small savings schemes. Interestingly, banks are offering higher rates on shorter tenures.

Doorstep banking services

RBI allowed banks to hire agents to speed up doorstep banking services. Now banks can pick up cash and cheques from individuals and corporate customers. In its guidelines issued, RBI said that where banks engage agents for delivery of services, they should have a policy approved by their respective boards which lay down broad principles for selection of agents and payment of commission. Banks will also have to comply with RBI directives on outsourcing services.

Cheque bouncing

Merely being the director or an employee of the company does not make one responsible for the offence of cheques bouncing, the Supreme Court has ruled. A person would be held guilty only when he is incharge at the time of commissioning of the act and is responsible for the conduct of the business of the company. The apex court said, "It must be shown how the Director and employees are incharge and responsible for the conduct of the business of the company. Merely being director or employees of the company does not make them liable for it."

Unclaimed dividends etc

Following the amendment to section 205B and insertion of Section 205C in the Companies Act, it has now become mandatory for companies holding any liabilities relating to any unclaimed dividends/matured deposits/debentures etc for over seven years to credit the same to the **Investor Education & Protection Fund (IEPF).** *This is the government-promoted fund maintained to educate the investors and create awareness amongst them about the changes taking place in the equity market, mutual funds and related avenues of investments.* The transfer of IEPF happens following the completion of seven years from the date of disbursal of such dividends/maturity of deposits/bonds. Thus unclaimed dividends etc will be permanently transferred to IEPF, and amount can not claimed by investors after seven years from the date they become due.

Repo in corporate debts

Repo, short for repurchase, is a transaction wherein a bond holder sells the bond for short period to another investor with an agreement to buy back the bond for a higher price at a later date. As of now, repo transactions are allowed on government securities. Repurchase agreements on debt instruments help increase liquidity, a problem with corporate debt instruments. The RBI is working out a framework for allowing repo transactions on corporate bonds. The corporate bond holder would have the option of entering into repo agreement, enabling him to raise funds against the security without actually selling it. This makes corporate bonds more attractive, which would go a long way in making debt paper a more tradable instrument in the secondary market.

7. MISCELLANEOUS UPDATES

The Egmont group

The Egmont Group – that now has 101 countries as its members – was established in 1995. It came into existence by the efforts by intelligence agencies in countries that decided to establish an informal group for cooperation between specialised agencies on money laundering. Since the decision was taken at the Egmont Palace in Brussels, the group came to be known by the name. All those who wish to become a member of the organisation have to meet certain requirements. Some of the agencies that are members of the group include Austrac of Australia, FinCEN of the US, Fintrac of Canada and Serious Organised Crime Agency of the UK. India is also willing to join the Egmont Group soon.

The Union Cabinet gave its approval for the exchange of information on money laundering activity, between the Indian financial intelligence unit (FIU) and other foreign FIUs. Now, New Delhi is all set to become a part of the intelligence organisation of FIUs – the Egmont Group.

Public-private-partnership

Private sector may take over government's outsourcing work via this route**.** India has just begun the journey of PPP through **the mechanism of sharing risk and reward over the asset's life cycle** in areas such as highways, airports, railways, ports and others. Its here the involvement of private players goes beyond the initial phase of constructing the assets by owning up the responsibility of maintenance over a specific period of time.

PPP would be ideal for many sectors where private enterprises bring in their efficiency in timely delivery with cost control. In fact, joint public and private enterprises may no longer remain confined to the domain of core sectors and if experts working on building capacities for PPP are to be believed, outsourcing of almost all-major government work may finally come under the PPP umbrella. What's more, partnership projects are equally visible in area such as municipal governance, health and education.

However, the emergence of the PPP model for infrastructure development, on a large scale, will pose major challenges. This new model does not call for a total retreat or withdrawal by governments, but only involves a shift to good governance, and requires an upgrade of regulatory, restructuring, and monitoring roles. Without significantly improved governance, the shift to increased PPP could just mean monopoly powers being shifted to the private sector and eventually become unsustainable.

PPP in Rail Budget 2007

The areas like passenger reservation system, parcels, catering services, retiring rooms and yatri niwas were already being outsourced. Now the container services, earlier being run by the railways after being converted into a corporation (CONCOR), is also being pushed to public-private partnership system. The railway is marching ahead by privatizing the subsidiary services and gradual downsizing of manpower. Railway minister Lalu Prasad Yadav said that I am not in favour of blind privatization. PPP is neither a compulsion, nor a fashion for us. We have enhanced our capacity by attracting private investments in wagon investment schemes, even while retaining the core activity of train operations. In fact, by leasing our catering and parcel services, the railway has, so far, reduced losses by Rs. 1,000 crore. Big plans and facilities cost money, and extra hands. So, Indian Railways is roping in real estate developers and utilizing public-private partnership (PPP) as part of its makeover plans. While the former are part of the modernization of 225 railway stations across the country, the PPP will fund a major portion of the dedicated rail freight corridor and high speed passenger corridor.

8. KNOWLEDGE RESOURCES

BPO experience

BPO companies operate as an extension of clients' enterprises and run customised end-to-end processes. And bring industry-specific knowledge to each engagement. Offshore outsourcing has become a potent weapon for global companies seeking to improve their financial performance. But many companies have yet to realise the full benefits that extend far beyond the cost savings. These advantages are the mushroom for BPO industry. Companies choosing outsourcing to strengthen their bottom lines, improve process quality, increase efficiency, enhance customer service, and develop compelling new products & services, besides increase in revenues. Today's outsourcing industry, which is expected to grow by 37% annually between now and 2010, is much more specialized than just a few years ago. It is largely due to the deep industry expertise provided by leading BPO companies.

Everything is being outsourced: *What was once considered the core of the telecom business is now being outsourced. The definition of the core is restricted to innovation, branding and effective marketing. From networks to IT and telecom towers to customer calls, everything is being outsourced. Bharti Airtel pioneered the concept, and it has been well lapped up by Hutchison, Ideal Cellular as well as well as Spice Telecom.*

Quality: Offshore BPO replicates process previously carried out internally, and performs them by utilising trained associates with industry-specific expertise. BPO companies recruit hundreds of associates from different professions. Associates are matched with assignments and provided with adequate skills. This approach delivers value added services to clients. BPO ensures business continuity, data security and regulatory compliance. It may increase productivity by more than 50 per cent.

Efficiency: Improvements in productivity, combined with 24x7 work capabilities, enhance efficiency. Capitalising on the time difference; BPO complete projects overnight. It allows each transaction to be handled quickly. Customer Service, innovation and additional revenue are the natural outgrowth of the quality and efficiency delivered by BPO, together with cost savings. The companies look at the bigger picture and realise these additional benefits. They are now willing to redesign processes and create new business models to maximise opportunities

Going abroad

The $9-billion Indian back office business is going global. While their clients are mostly global, Indian BPO companies are now looking at much larger presence overseas. New stops for Indian BPOs and KPOs include Santiago in Chile, Guatemala in Central America, Colombo in Sri Lanka, Bucharest in Rumania, Sao Paulo in Brazil, the Czech Republic and Belgium. Besides, the 5, 00,000 people Indian BPO industry is even exploring South Africa, Morocco, Nigeria, and Dubai for future expansion. Reasons for such moves span de-risking operations, getting close to customers, access to high-end skills, language and low to even zero attrition for operations in countries like Dubai. Of course, countries around the world are also attracting work with attractive tax breaks and better infrastructure.

The largest BPO, Genpact which has 26,000 people in India expects 20-25% of its workforce to be in overseas centres in future. Despite destinations like Rumania being 15-20% more expensive than India, the 16,000 plus people Wipro BPO sees rapid growth in its overseas centres. The reality is that people want a near shore presence as well. Ultimately it will be a follow the sun strategy – do processes in the client' time zones. While overall India is still the best option, companies could also be driving overseas moves with a view to de-risk operations and the recent rise in taxes. Overseas delivery centres also help companies address new markets and tap diversified talent.

9. LIFE INSURANCE POLICIES

That being the basic principal, there can be no over-the-counter insurance solutions. Each person's insurance requirements are different, and depend on the purchaser's age, income level, preferences, risk profile and expected commitments. There are two components to life insurance policies. One is a financial benefit to the family, i.e., protection against loss of income in case of death of the earning member of the family. Second, benefit to the policy holder in case he survives the policy term. Hence, life insurance policies can give dual benefits of investment and protection.

Term plans is a pure-play for risk cover

Term insurance is a pure-play risk cover at dirt cheap premiums. These don't offer any money at the end of the term on survival. The policy lapses if there is a failure to remit premium during the tenure and there is no surrender value. Most insurance companies don't seem to promote these products extensively, and insurance agents prefer to sell other products because of better commissions. But families are feeling the need for a good cover and hence term policies are finding many takers. Don't, however, take a single premium policy as there are no tax benefits. Besides, the lock-in deprives you of investing elsewhere for better return. And in the event of the unfortunate happening too soon, your family will not get a refund of the unutilized premium.

The Need

If you want to secure your family's future; uncertainties could happen at any time; one must definitely opt for a term policy after marriage or when you have long-term loan liabilities.

The Coverage

Insurance should provide capital for today's needs and safeguard against future need for income. You should also consider inflation, which eats up the purchasing power of money in the long run.
One should keep revisiting the quantum of cover regularly and add depending on future requirements.

1 crore life insurance policies dead

Believe it or not, a whopping one crore life insurance policies with a total sum assured value 74,076 crore lapsed in 2005-06. These numbers, released by IRDA for the first time, do not include Ulips that lapsed during the period. Had these been considered, the figures would have been much higher. Number of policies in force were about 18.31 crore.

According to IRDA data, as many as 1.4 crore policies were discontinued of which 1.01 crore were lapsed policies. Discontinued policies include policies terminated by death, maturity, lapses, surrenders or cancellations. The break-up shows that 93% of the lapsed policies, 95.69 lakh were with LIC with a total sum assured value of Rs 61,640 crore. In the private sector, ICICI Prudential had the largest number of lapses at 1.36 lakh (Rs 1377.46 crore). It was followed by Max New York Insurance (MNYL) with 1.04 lakh policies (Rs 2657.78 crore). Tata AIG at 92,940 policies, Bajaj Allainz 66,470 policies, HDFC Standard Life 40,550 and Ing Vysya Life Insurance 40,730 followed MNYL.

WHO DARES WINS

Alka Agrawal
Promoter of Mi7 & SAFE

Financial Literacy Mission

A crash course of literacy

Missions Seven Charitable Trust

120/714, Lajpat agar, Kanpur - 208005
Phone 0512-2295545

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Congratulation: Chandra Das, Income Tax Officer