INDIA: REFLECTIONS ON THE ECONOMY, EMPLOYMENT, BUDGETS, AND TAXATION

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ECONOMY

Criminalisation of Corporate India

Siddarth M Pai and Shankar Jaganath

John Locke, in his seminal work 'Two Treatises on Government", highlighted that punishments should be governed by three legitimate motives: reparation, restraint and deterrence. The legitimacy of punishment is upheld when "laws of nature", the inveterate body of moral principles that forms the basis for all human conduct is violated and not for the violation of an arbitrary rule. Of the motives stated above, reparation is the first preference since its restorative, often taking the form of a pecuniary punishment or a restoration of property. Restraint is advocated only to secure mankind from "from injury and violence, being slighted and broken by him". With this, Locke honours the liberal principle of the paramount nature of freedom and how the restriction of freedom is only necessitated in cases most egregious.

Thus, incarceration and criminalisation, which strip the perpetrator of the bare basics of citizenship and freedom, is considered the "ultima ratio" – the last resort. However, in India, especially in our corporate laws, the last resort of imprisonment also seems to be in many cases the first response.

The insertion of a 3-year imprisonment term for violating Corporate Social Responsibility (CSR) norms in India is the latest in a litany of 50-odd criminal measures instituted against officers in default, which could include directors, in the Company's Act 2013, the primary statute governing corporate law in India. This act, instituted by the previous UPA government, arbitrarily mandates imprisonment for seemingly civil offences that are harsher than those in the Indian Penal Code. For contrast, the sentence for violating CSR is longer than the sentence for causing death by negligence (Section 304A, IPC – 2 years).

This criminalization of civil offences that has seeped into corporate statutes belie a virulent distrust of businesses and businessmen. Criminal law deals with offences against the public, society, or the state and acts of moral opprobrium or acts of violence against individuals; civil offences in contrast, involve damage to property of an individual or group of individuals – and each should follow the legitimate purposes of punishment that is restorative and act as a deterrent. Yet the Companies Act disregards this and affords criminal sentences to civil offences by companies, some examples of which are listed below:

- Violation of share buyback norms (Sec 68) – up to 3 years
- Failure to repay deposits or interests (Sec 74) – up to 7 years
- Declaration of dividend without paying it (Sec 127) – up to 2 years
- Violating CSR norms (Sec 135) – up to 3 years
- Default in constituting committees (Sec 178) – up to 1 year
- Contravention of inter-corporate loans and investments (Sec 186) – up to 2 years
- Failure to provide the government statistical info (Sec 405) – up to 6 months

A key question to ask here is Cui Plagalis – who loses, and is this loss permanent? For default in constituting committees of the board or failure to provide statistical information to government, a criminal sentence is a disproportionate measure of retribution compared to the act of omission by the company or its officers. In such matters, what is the purpose of imprisonment? Reparation – it doesn't resituate any property to the shareholders or government; restraint – these acts don't pose the threat of violence to anyone; deterrence – unless these are wilful acts of fraud, these penal clauses demonise rather than deter directors.

A law is only as effective as it is enforced. Enforcement of penal provisions in corporate India is not only erratic but also cyclic and comes into focus only in the aftermath of prominent scandals. In other periods, non-compliance is either not systematically pursued and punished or consciously ignored for reasons of being impractical, like what is being advocated in the case of imprisonment for CSR lapses, without amending the law by revoking the impractical provision. Further, lenient treatment accorded to non-compliances by the public sector companies by not enforcing the penalties also begs a question of the nature of example set for Indian corporates that can act as deterrent.

In UK, from where we can trace Indian corporate law, penal provisions with imprisonment as punishment are preceded by the words like "knowingly", "recklessly", "misleading", "false or deceptive". Further, they provide an exit clause where the officer in default is exempt from this harsh punishment if he/she can show that they acted honestly.

In a civil society, acts that deprive a person of their freedom should be reserved for most egregious of crimes. Instead, in India it looks like criminal sentences are a signal to show how seriously lawmakers take an issue. Further, this renders these punitive measures are liable to misuse. The Shri Injeti Srinivas committee to review offences under the Company's Act also echoed the same in its report submitted on August 14th, 2018 and made numerous suggestions to decriminalise our corporate laws. Full translation of their recommendation to law is still awaited.

In a July 2018 speech, the honourable Prime Minister said, "…the efforts of industrialists too have a role in nation building. Should we insult them, call them thieves and robbers? Is this the way?" If this thought is to be translated into action, it is time that India reviews the entire penal provisions, especially the one related to imprisonments in the Companies Act, 2013 and make laws that honour the efforts of industrialists and entrepreneurs in nation building.

Link: Criminalisation of Corporate India

Criminalisation of corporate India

The penal provisions, especially those involving imprisonment, in the Companies Act, 2013 are disproportionate retributive measures compared to the acts of omission by companies or their officers

SIDDARTH M PAI & SHANKAR JAGANATH

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LETTERS TO THE EDITOR

Benchmarking banks' bulk deposit rates

Apropos of "Time for bench-marking bulk deposits rates of banks?", in 2008-2009, few banks had introduced floating interest rates on deposit. It may be noted that, in India, interest rates on fixed deposits are much sought-after and a deciding factor in choosing a bank to park deposits. Not in savings bank accounts, which are daily-need based. It is about time savings bank deposits rates call for embracing floating interest rates. It is imperative to note savings deposits serve our routine needs. A large chunk of salary credit, bulk of PF contribution on salary disbursal day, government subsidies and CSR funds also find way giving spikes to savings deposit balances. Linking savings bank accounts with floating rate of interest would further give boost to sluggish savings bank deposits growth. Majorly, customers use savings bank accounts for taking care of day to day transactions. It is a shield against interest rate flections. We need to educate customers about the floating rate savings bank accounts. It would be interesting to update them about the importance of how spikes, at times, will help good interest in their savings account balances. Customers can hold their savings to reap the benefits of high floating interest rates and put on hold heavy withdrawal for some time, if any.
— NK Bakshi, Vadodara

For a fiscal overreach

Apropos of "Raising deficit by cutting tax rates...", consumption is no longer fuelled by the lower income sector that lacks purchase power, even as the middle one keeps away from white goods on uncertainties of the future. Spending does not create wealth, production does, and that needs a healthy pool of savings. The burden of investment for growth should revert to the government. A mix of policies that channel funds to lower strata for consumption, enable savings to the next and calibrated tax incentives for the job-creating capital should help revive the economy.
— R Narayanan, Mumbai

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Universal Declaration of Digital Rights

FOR LIFE, LIBERTY, AND SECURITY IN THE DIGITAL REALM

TV Mohandas Pai and Nisha Holla

In 1948, the United Nations established a historic mandate by adopting the Universal Declaration of Human Rights. For the first time, there was a declaration of inalienable rights for all humans. Coming at the tail end of five hundred years of violent invasion, occupation, slavery, colonization, and two devastating World Wars, the Universal Declaration facilitated fundamental change in the way democracies and other governance systems worked. By and large, a wave of peace and respect for fellow humans across the world emanated from the Declaration.

As we head into 2020 and a new decade, looking back brings into sharp relief the digital revolution that has swept over the world. Societies have increasingly moved towards the use of digital devices to increase their communications and knowledge. Of the approximately 7.7 billion people on the planet today, roughly 4.5 billion have access to the internet (https://wearesocial.com/blog/2019/10/the-global-state-of-digital-in-october-2019).

Contrast this with 2000, when only 738 million people had access to the internet. Social media was almost non-existent, whereas today, 3.7 billion are active social media users. The adoption of digital across the socio-economic spectrum has fundamentally changed the way we live and access information, goods, and services. Every part of our lives can be digitized, tracked and logged. Everyone has inevitably become a digital citizen.

On the digital provider side, we see the rise of digital monopolies that have grown so large in the last two decades; they effectively exercise control over most of the world. These monopolies started in different forms – Google as a search engine, Facebook as a social media network, Amazon as a digital shopping site, and so on. Today, these giants are akin to supermassive black holes slowly agglomerating a galaxy of services around their irresistible gravitational pull. They keep growing, they keep aggregating (like Facebook bought Instagram and Whatsapp), and they keep amassing data of the common global citizenry.

When one newly signs onto a digital platform, there is a long and oft-unread set of Terms and Conditions. These T&Cs effectively mean we have given away the rights to our data resulting from the usage of the platform to the managing company, such as Google or Facebook. The data now belongs to them and not to us. They can use it however they want to, including in ways leading to monetization. Most importantly, if there is a security breach, they cannot be held responsible. Moreover, since these companies are American, for example, Indians have no standing in US courts to take legal action against them for breach of private data.

On the one hand, in this knowledge-economy era, access to digital platforms and the internet is a necessity. On the other, there is effectively no protection of the data on the web with digital monopolies and data piracy. Loss of privacy has led to massive personal losses, financial and otherwise. Cambridge Analytica was one of the biggest eye-openers about the use of personal data harvested off Facebook without consent to try and influence elections. The inalienable rights mandated by the UDHR is openly in question because of the wild nature of the internet that was an unknown entity back in 1948.

It is time to formulate a Universal Declaration of Digital Rights that upholds the spirit of the UDHR in the digital realm.

There are different principled positions across the globe on what constitutes stable digital security. On one extreme is China which has created a firewall around their network, effectively restricting the digital services and websites Chinese citizens can access. China is a surveillance state where all notion of privacy has been quashed. On the other extreme is a zero-censorship state where there are no restrictions, and every citizen will have to look out for their security. No nation is at this extreme today because there are fundamental problems which cannot be handled with a zero-censorship policy like controlling child pornography, rampant sale of drugs on the internet, and so on. Most states have adopted censorship and data security policy that lies somewhere in between these two extremes of total control and zero-censorship.

Fundamental questions are being raised over individual protections in the digital age. Governments are waking up to the vast amounts of personal data companies store about their citizens and what it is being used for. The European Union recently formulated a significant boost to its data protection laws with the General Data Protection Regulation (GDPR). The GDPR lays out a framework to protect data that are personal identifiers like names, contact details, geo-location, and indicators like race and religion. It mandates that users or data subjects – who are providing their data to use a platform service – are accorded the rights to be informed about the usage of their data especially in automated decision-making and profiling, to access their data and port it, to rectify or erase their data from the platform, restrict processing, and raise objections.

GDPR places the burden on organizations to prove that they have a legitimate reason for holding onto personal data, to be much more upfront about data storage, why, and how it is being used, and use simple language while explaining data opt-in and opt-out. Moreover, if their database is hacked, they must notify users within three days, and immediately if they are at high risk like the cases when personal non-anonymized data is breached. Non-compliance warrants hefty fines and public outcry.

Today, organizations have a default opt-in procedure, with often no way of opting-out without getting off the platform altogether. With frameworks like GDPR making the fundamental assumption that people want control of their data, the right to opt-out, specific ways to opt-out, and demanding clarity on what to opt-out off is paramount. Moreover, since the GDPR mandates that not only EU-operational companies but any company with European users have to comply, this legislation now extends practically to the whole world. India is also active in the process of understanding how to protect its citizens' data so that we can pass legislation similar to GDPR.

The right to privacy is a prime example of a digital right which would include the right to have secure encryption implemented and to private digital communications. The right not to be profiled includes freedom from automated profiling and bulk surveillance, the right to get information about your data, to keep personal data protected, to opt-out of profiling, and anonymous access and participation. Another digital freedom worth putting on paper is the right to personal safety and security, which would include protections from the leak and abuse of your personal data. Rights to digital self-determination including control of our data, to object to the use of personal data, to challenge/opt-out of standard terms and conditions, to portability, and others are another example of sacrosanct rights.

These are but a sampling of some rights that a Universal Declaration of Digital Rights must formulate and mandate. Apart from affording personal protections, the UDDR will also form a basis for resolving digital conflicts like hacking, cyber-security and national security matters between nations.

While it is essential for every country to safeguard its citizens' interests, the time is ripe for a multilateral agreement – a Universal Declaration of Digital Rights – with an unambiguous and aligned view of the inalienable rights of the modern digital citizen. The principles of the UDHR where everyone has the right to life, liberty and security must now transcend to the virtual realm.

Link: Universal Declaration of Digital Rights


TV MOHANDAS PAI & NISHA HOLLA

UNIVERSAL DECLARATION OF DIGITAL RIGHTS

For life, liberty and security in the digital realm

The right to privacy is a prime example of a digital right which would include the right to have secure encryption implemented and to private digital communications

FINANCIAL EXPRESS

The Grand USD 5 Trillion Plan

TV Mohandas Pai and Nisha Holla

Prime Minister Modi has given India and its citizens a lofty goal of maturing into a $5tn economy by 2025. Every growing country needs an ambitious goal, so everyone is aligned and focused on reaching it. To reap this vision, we must first take stock. In FY 2018-19, India's GDP is estimated to be INR 190 lakh crores or $2.7tn (at INR 70 = 1 USD). Say we grow at 8% for the next six years, with inflation at 3.5%, yielding a nominal growth rate of 11.5% - in constant currency of INR 70 = 1 USD, starting at $2.7tn - the $5tn goal is well within reach. Putting aside considerations like the depreciation of INR, the critical issue is, can we reach this goal of 8% growth over the next six years?

When India's economy opened up in 1991, GDP was $275bn; reaching $2.7tn today translates to a growth of 8.5% per year in dollar terms. 8.5% p.y. is phenomenal growth and a **testimony to the healthy growth drivers India possesses**. Given India's strong 28-year history and capacity for growth, the authors estimate that the probability India reaches the $5tn goal is more than 80%.

Several policy initiatives are required in the next six years to maintain the 8% growth rate and reach the $5tn target:

1. **Stable society**: PM Modi has already laid the foundation for providing basic amenities to every Indian citizen. By 2021, every Indian will have a roof over their head, food on the table, a gas connection, and so on - need will disappear, and everyone can aspire to improve quality of life. *Economic growth cannot occur in a sea of poverty*, and PM Modi has worked hard to solve India's biggest problem.

2. **Improve productive sectors:** Data shows 42.7% of India's workforce in 2016-17 was engaged in the agriculture sector crawling at a 3.4% growth rate and contributing only 17.3% to the GDP. Meanwhile, 57.3% of the workforce was engaged in industry and services growing at 5.5% and 7.6%, respectively. This is resulting in high income inequity. By 2030, India must move a majority of agriculture-dependents to industry or services. 10% of the workforce engaged in agriculture is sufficient - the US and China have both done this, while successfully producing food surpluses in the agriculture sector. *The highest value-add is in the services and industry sectors*; expanding them with skilled labour and incentives will contribute heavily to our economic growth.

Sector	% GVA	GVA growth rate	Workforce distribution	Per-capita GVA (INR)
Agriculture	17.3%	3.4%	42.7%	41,621
Industry	29.0%	5.5.%	23.8%	1,25,231
Services	53.7%	7.6%	33.5%	1,64,569

Table: 2016-17 data comparing agriculture, industry and services sectors in India across share of Gross Value Added, GVA growth rate, workforce distribution and per-capita numbers. Data from RBI, MOSPI and World Bank

3. **Urbanize with labour-intensive industry (LII) clusters:** Urbanization aggregates human activity and boosts productivity and specialization. Rapid urbanization is necessary to provide jobs for all – this is not in the ten major cities but by developing 5000 small towns all over India. By creating LIIs in and around these towns, people all over the country will have proximity to well-paying jobs instead of migrating en masse to the major cities. With careful planning, this network of *5000 small towns will become India's growth engine.*

4. **Infrastructure development and Supply chain:** India's construction sectors needs a significant boost – roads, railways, ports, tourism infrastructure, power surplus infrastructure, and more. The speed of carriage of goods on railways needs to increase from the current 25kmph to 50-60kmph. While contributing to economic growth (like in China), this move will also *provide mass employment and a logistical backbone* to boost India's industrial and export capabilities and supply chain efficiency. Today our supply chain costs are 14% of GDP, absurdly high. The GST is a great venture and is already reducing supply chain costs by 2%; with enhanced transportation and the creation of a common market for India, costs could come down to 8-9% in the next three years.

5. **Jobs and Skilling:** India needs 15 million jobs a year, but only 11-12 million are counted. The problem is not a shortage of jobs, but that of low-quality jobs and wages. Mass employment and skilling through LIIs and the construction industry can solve this problem. Similarly, incentivizing specialization through higher education and research will build a workforce pipeline for hi-tech and other high value-add industries.

6. **Tax and Justice:** Tax terror has hurt India badly, and litigation has doubled in the last five years. The tax justice system needs reforms to reduce unnecessary litigation and stop tax terror. There is an urgent need to lower corporate taxes to 25%, the worldwide average, to allow our large companies to grow and compete globally.

7. **Judicial reforms:** It is imperative to improve our judicial infrastructure and police investigative capacity - so justice can be served to the aam aadmi in three years as opposed to the current 15-20-year horizon. There are 250,000+ awaiting trial in prisons, reduced to a situation where their court date never comes up and are too

poor to post bail. Today, we have 18 judges/million population; this must grow to 50 in 5-6 years. The capacity of the police to investigate and keep up us safe must also increase. A great society can only be built on the foundation of a strong justice system that is available to all.

8. **Digital economy:** India is rapidly moving from a data-poor to data-rich country. Most Indians now have digital identities. With 1bn+ mobile phones, 560mn+ internet connections, and 350mn+ additional bank accounts opened since 2014, our digital economy has reached scale. We are already capitalizing on this through new payment modes, e-commerce, and startup entrepreneurship. However, our data and platforms are owned by US, Chinese and Japanese companies – Google, Facebook, Twitter, Tencent, Ali Baba, and others. About $50bn capital has entered the ecosystem since 2014, of which less than 10% is estimated to be Indian. *We are in danger of becoming a captive digital colony,* a situation that can only be remedied by taking ownership of our data and platforms. We need laws for keeping Indian data in data centers within our borders. We must also infuse the system with more Indian capital - careful implementation of the announced $1.5bn Fund of Funds under GoI's Startup India is a need of the hour.

9. **Banking:** India has been phenomenal in the banking sector which can be a strong growth driver. Total lending to GDP is just over 50%, while total deposits to GDP is just over 65%. These ratios can be incentivized to grow with increased infrastructure, integrating technology and building a robust banking sector.

10. **Empower big cities:** India's big cities are engines of growth – Mumbai is a financial hub, Delhi is the seat of political and growing technological power, Bengaluru is a global technological hub – but are starved of resources. Take Bengaluru for example – it is the richest city in India with the highest per-capita income and pays a tremendous amount in tax which is spent on the rest of Karnataka. With no budget allocation to Bengaluru, it has inadequate infrastructure with no capacity to deal with the continual immigration from the rest of the country. Despite its financial underpinning for the state and country, Bengaluru is politically insignificant. High-growth cities like Bengaluru must be made self-governing with a full-time mayor and in-charge of its own allocation. That allocation can then be spent on improving infrastructure and mobility to boost productivity. *Every major Indian city has potential to become a global hub* in various domains (like Silicon Valley or Shanghai) which will, in turn, boost India's economy.

11. **Higher education:** *A nation's true worth is in its higher education system.* The US' political and military strength stands on the innovation of its universities and research labs. India must reform its higher education system, give autonomy to its universities,

and set up state-of-the-art research labs to attract the best talent. Policymakers must focus attention on improving GER and quality of education.

12. **Good governance:** PM Modi has set the tone by ensuring there's no corruption in Delhi. We need government at all levels to work with the people to implement policy that is effective and responsive to the needs of citizens.

13. **Role of States:** We are now in an era where the role of the Center is increasingly limited, and State spending is growing. State GDP across India varies enormously, driven by population dynamics, fertility and other factors. India cannot develop unless its highly populated areas in the North-Central-East regions become prosperous. Just like Maharashtra CM Fadnavis has put forth a farsighted vision of a $1tn economy by 2025 to match PM Modi's $5tn goal, we need CMs of each state to evaluate and execute a long-term plan and vision for their state.

India is a colossus with profound civilizational heritage and tremendous potential for global impact. For most of history, India was the largest economy in the world. On this Independence Day in 1947, we won our freedom through the largest-ever freedom movement in the world – ultimately liberalizing 60% of humanity from the throes of colonization. Today, India has to play its role as the largest democracy - to demonstrate how to build a sustainable system based on justice, meeting the needs of its billion+ citizens, and where every young person and citizen can dream of great achievements. Only India can lead the way.

Link: India's grand $5 trillion goal, and the policies to achieve it

Maharashtra 2025 - The Road to GDP USD One Trillion

TV Mohandas Pai and Nisha Holla

Prime Minister Modi has given India and its citizens a lofty goal of maturing into a USD 5 trillion by 2025. Every growing country needs an ambitious goal, so everyone is aligned and focused on reaching it. India is currently at nominal GDP of USD 2.7 trillion – if we grow at a CAGR of 11% for the next six years in constant currency of INR 70 = 1 USD, the USD 5 trillion goal is well within reach.

Data shows Maharashtra is clearly India's leading state. In a time when the role of the Center is increasingly limited and state spending is growing, Maharashtra has demonstrated how states must lead. This is reflective in the **state's strong leadership, robust growth drivers, and stable finances**. Maharashtra Chief Minister Devendra Fadnavis recently announced a remarkable vision for the state to become a USD 1 trillion economy by 2025. This is congruent to PM Modi's vision to catapult India towards a USD 5 trillion economy by 2025. Just like national economies need a bold vision, so do growing state economies.

Per the Economic Survey of Maharashtra 2018-19, advance estimates of the state's GDP in 2018-19 is INR 26.6 lakh crore or USD 380 billion. Of India's total USD 2.7 trillion, Maharashtra's contribution to the national GDP is 14%. Going by the goal to hit USD 1 trillion when India aims for USD 5 trillion, Maharashtra needs to contribute 20% of the national GDP in 2024-25. This means **Maharashtra must accelerate more than India to hit its target**.

Data from RBI shows Maharashtra has grown from INR 17.8 lakh crore in 2014-15 to INR 24.97 lakh crore in 2017-18, at a CAGR of 12% (Table 1). If the state continues growing at 12% CAGR, it will **only reach USD 785 billion in 2025, in constant currency; falling short of the USD 1 trillion mark**. Growth needs to accelerate at 17.5% CAGR over the next six years. Business-as-usual (BAU) will not get Maharashtra there. Policy frameworks must change to accelerate to 17.5% growth.

Year	GVA (INR lakh crore)			GDP (INR lakh crore)
	Services	Industry	Agriculture	
2013-14	7.71	5.05	1.37	16.50
2014-15	8.75	5.36	1.15	17.81
2015-16	9.74	5.85	1.18	19.87
2016-17	11.05	6.26	1.63	22.57
2017-18	12.60	6.70	1.40	24.97
3 yr CAGR (Base 2014-15)	**12.91%**	**7.73%**	**6.63%**	**11.92%**
Projected 2024-25	**29.47**	**11.29**	**2.19**	**54.92 (USD 785 bn)**

Table 1: Maharashtra state GDP, data from RBI, projections by authors

A study of sectoral GVA since 2014-15 yields the following – agriculture grew at 6.63%, industry at 7.73%, and services at 12.91%. To reach the USD 1 trillion goal, we must answer two questions: One, by much do these sectors have to accelerate, and two, **what levers are available within these sectors to accelerate growth**?

As economies enter an advanced growth phase, services sectors become primary growth engines. With 61% services contribution to GVA in 2017-18, Maharashtra is on this path already. While services consist of a diverse basket of sub-sectors, the three biggest growth drivers are IT services, financial services like banking and insurance, and tourism. The industry sector contributes 32% currently but includes under-utilized growth drivers in manufacturing and construction. Our economic model suggests industry sector must accelerate to 16.5% and services to 17% CAGR for the next six years for Maharashtra to hit the USD 1 trillion mark.

A survey of other state economies demonstrates that though Maharashtra leads in economy size - by far - it lags in growth rates across sectors and sub-sectors. By studying what the leading states – by CAGR – are doing, we put together a model to accelerate Maharashtra's growth by specially boosting sub-sectors with potential for the highest growth and value-add.

IT services is a major growth driver. The MOSPI CSO report indicates value-add is 70.6 - it has the advantage of mass employment of specialized workers with high pay. In 2017-18, total IT services exports for India was USD 137 billion which translates to INR 9.6 lakh crore. Share of Karnataka's IT services exports is 38% - translating to INR 3.65 lakh crores, while Maharashtra contributes about 20% - translating to INR 1.91 lakh crore. This is the reason Karnataka and Telangana have impressive ~15% CAGRs in services - because of IT services, and other technological drivers, centred in Bengaluru and Hyderabad.

Financial services is another growth driver. Mumbai is already India's financial leader – with NSE, BSE, RBI, SEBI, and headquarters of most big banks. MOSPI CSO data indicates value-add of this sub-sector is 72.0. Mumbai has the potential to be a global financial hub on par with Singapore or London – it has the skills and human capital to do this; only needs the infrastructure and policy initiatives like special tax breaks and handling convertible currency. With boosts in IT services, financial services and tourism, the overall services can accelerate to CAGR of 17%.

Industry sector CAGR of 7.73% is very low compared to the potential of India's 'Most Industrialized State'. **Two major levers in the industry sector can contribute to accelerated growth – manufacturing and construction.**

Labour-intensive manufacturing industries will accelerate industry growth as well as provide mass employment. Maharashtra's proximity to the Suez Canal and access to markets like Europe, Africa, and the East Coast of the US, is an **underutilized geographical trade advantage**. The state needs coastal SEZs where labour-intensive industries with export advantage like garments, fabrication, electrical machinery, and others can be set up. Apart from this, investment in specialized hi-tech industries like electronics component and hardware design, 3D printing, defence parts manufacturing, and others will provide higher value-add to the economy.

Construction growth is 5.36%; very low, not just in Maharashtra but all over India. Looking for better construction sector models elsewhere, China is a great case study. China rapidly urbanized from 26.4% in 1990 to 59.2% today. Urbanization significantly boosted the construction industry which grew at an average annual growth rate of 16.6 percent since 1978. Maharashtra must follow China's construction model and commission large-scale infrastructure projects all over the state – roads, railways, Metro, ports and seaside living spaces, tourism infrastructure, airports and low-cost housing. Maharashtra must avail 20-30 year loans from development banks like it has from the Asian Development Bank for the MMGSY project. The construction industry has highest backward linkage in terms of metal consumption, mass employment, and generation of taxes. With these boosts, the industry sector CAGR can be incentivized to grow at least 16.5%.

Economic growth cannot reach its potential without all communities and regions growing at pace. A study of Maharashtra's districts indicates population-weighted average per-capita GVA of the ten richest districts is 2.5 times that of the ten poorest (Table 2) – there are clearly two Maharashtra within one state! To make the districts grow faster, **implementation of NITI-Aayog's Aspirational District model** is opportune. Additionally, a **model for systematic urbanization** in 300 smaller towns across the state cross-linked with infrastructure development and creation of labour-intensive industries will aid the urbanization of the state and growth in all regions, not just the six main cities.

Poorest Districts		**Richest Districts**	
District	**Per-capita GVA (INR)**	**District**	**Per-capita GVA (INR)**
Washim	75,489	Sangli	1,53,034
Nandurbar	78,095	Nashik	1,56,979
Buldhana	80,508	Ratnagiri	1,68,569
Hingoli	81,224	Kolhapur	1,79,170
Gadchiroli	85,727	Raigad	1,99,452
Yavatmal	96,240	Sindhudurg	2,03,548
Beed	97,595	Nagpur	2,05,878
Osmanabad	98,590	Pune	2,34,108
Jalna	1,00,253	Thane	2,49,897
Parbhani	1,02,553	Mumbai	2,94,764
Pop-weighted avg.	**90,981**	**Pop-weighted avg.**	**2,28,859**
Maharashtra state per-capita GVA (INR)			**1,72,882**
India per-capita GDP (INR)			**1,31,698**

Table 2: Maharashtra's richest and poorest districts, data from ESM 2018-19

Maharashtra leads in formal employment generation as well, per EPFO data shown in Table 3. It is crucial to enhance this further as a pipeline into specialized industries and services. In turn, **developing higher education infrastructure is key**. Maharashtra's Gross Enrollment Ratio was 31.1 in 2017-18 and projected to reach 37.6 in 2024-25. With the right policies and incentives, Maharashtra can improve GER to 45.0 by 2025 and 55.0 by 2030.

Age Group -	< 18	18-21	22-25	26-28	29-35	35+	Total
Maharashtra	12,562	5,31,060	4,86,518	1,68,034	2,05,359	1,72,410	15,75,943
India Total	95,076	23,42,998	17,71,705	5,78,759	7,64,744	5,58,941	61,12,223
% MH to India	13.21%	22.67%	27.46%	29.03%	26.85%	30.85%	25.78%

Table 3: Data from EPFO for 2018-19

The future is in the innovation-driven knowledge economy, led by start-ups and technology companies. Maharashtra is already a leading state in the ecosystem, second only to Karnataka. Maharashtra must create an INR 5,000 crore Fund-of-Funds to invest in and grow start-ups. Creation of Centres of Excellence for specific large-impact fields will act as force-multipliers to economic growth for decades to come. Further, research laboratories and innovation hubs will enable the state to become a pioneering innovation economy in which industry, manufacturing, and specialized services can grow.

The only limitation to implementing a lofty goal is imagination and Maharashtra has demonstrated plenty. The state would do well to study and learn from other economies to fuel its plans. China, in particular, has carefully implemented far-reaching plans by setting lofty goals, and then studying and executing them. Moreover, with comparable populations, China is the only country where the scale matches what Maharashtra, and indeed India, now need to execute at to catapult the economies.

With careful planning, Maharashtra can certainly get close to the USD 1 trillion mark. Undoubtedly, the state has set a standard for bold visions and execution for other India states to aspire to. If every state works out a plan for exponential growth and executes, this is how India takes its rightful place as a Top 3 economy soon.

The authors have prepared a detailed report on this topic which will be published online soon. Interested readers can refer it for more details.

Link: How Maharashtra Can Reach Target $1 Trillion By 2025

Modi ne kya kiya? The voters answered!

TV Mohandas Pai and Nisha Holla

Prime Minister Narendra Modi's resounding victory in the 2019 Lok Sabha election took many by surprise, especially in the Lutyens Media. Several among the opposition asked the **rhetorical question - *Modi ne kya kiya?*** - to cast him in bad light. They were oblivious to the intense development undertaken by PM Modi that touched millions of citizens, many for the first time.

Some TV interviews feature journalists asking villagers what PM Modi did to get their votes - ***Bolo Modi ne kya kiya tere liye?*** - in blatant attempts to provoke them and get negative answers. However, villagers all over India are emphatic in their response about why wanted PM Modi back for another five years. They have witnessed the changes through their own eyes. A lot of them have had direct benefits. Interestingly, some of the individuals answering the journalists hadn't received direct benefit themselves but knew someone who had. They enthusiastically said '*mere padosi ko gas connection mila hain*', '*woh gaon main ab bijli hain*', '*hamne dekha hain*', and most importantly '*vishwas hain ki hame bhi milega*'. The reelection is testimony to the benefits many Indians have received in the last five years.

So how do we answer this question - *Modi ne kya kiya?* With data, of course!

Under PM Modi's leadership in the 2014-19 term, the NDA-I government grew the GDP by an estimated INR 78 lakh crore in nominal terms, **a growth of 69.2% over five years at a CAGR of 10.9%**. Estimated per-capita GDP grew from INR 0.9 lakh in 2014 to INR 1.45 lakh in 2019, a growth of 59.7% in five years - the largest growth witnessed in our recent history. Data from ESI, EPFO and other sources like sale of vehicles show one crore jobs are being created every year in India. In these five years, providing basic amenities to the poor was prioritized and the results are staggering.

No other Prime Minister of India has done so much for the poor in one five-year term as PM Modi has. He is ensuring every Indian has access to the basic necessities of life:

- A roof over their head – **1.53 cr homes** were built post 2014, a majority of them in the rural areas.

- A toilet in the house - Individual household latrine **(IHHL) coverage is now over 99%**, up from 38.7% in 2014. In five years, 9.67 crore latrines were built, and 94.08% villages and 28 states have been declared as ODF.

- Power in their switches – **100% electrification was achieved in 988 days** covering 17,181 villages, up from around 96.7% in 2014. 2.5 crore poor households were electrified, and the work to provide reliable power continues.

- Food on the table – **Food security coverage has been extended to all 36 states/UTs** of India from just the 11 states/UTs in 2014 as per the National Food Security Act, under which the government is supplying 5 kg of food grain each per month to over 80 crore people at a highly subsidised price.

- Gas connection in the kitchen – **13 crore gas connections** were distributed in five years bringing the total to around 25 crore. Of these, 7.19 crore connections have been provided free to rural women, enabling them to cook smoke-free and improving their health dramatically.

- Rural road connectivity – Today 91% of villages are connected with roads, up from 56% in 2014.

- Access to education – Apart from schools, enrolment in higher education has also jumped from 3.23 crore in 2014 to 3.66 crore in 2018. **More Indians, including women, are aspiring to becoming graduates.** The Gross Enrolment Ratio of women has risen from 22.0 in 2014 to 25.4 in 2018. It is essential to create eligible jobs for all of them now.

- Mobile phones – TRAI data shows the wireless subscriber base in March 2019 was **1.16 billion**, up from 0.9 billion in 2014. Of this, 511.3 million are in the rural areas. Access to mobiles has transformed how people in the rural areas (and urban) do business and earn a livelihood.

- Access to internet and digital platforms – The internet subscriber base, per TRAI, has increased from 251.6 million in 2014 to 563.3 million in March 2019. Apart from this, **1.19 lakh gram panchayats have been connected with optical fiber** for citizens to access their bank accounts and DBT digitally.

- Bank accounts – Through the Jan Dhan Yojana, **35.65 crore bank accounts were opened** in five years. Total deposits have crossed INR 90,000 crores. Over 53% holders are women.

- Direct Beneficiary Transfer – DBT has enabled the government to **provide INR 7.3 lakh crore over 439 schemes** over the last five years, directly to citizens' Jan Dhan bank accounts

- Small business loans – Through Mudra, **loans worth more than INR 8.6 lakh crore** have been disbursed to more than 18.2 crore beneficiaries to start their own businesses and aspire for a better life

- Insurance cover – Since 2014, **21.68 crore people have availed insurance** for accident and disability coverage, life insurance, and so on.

- Farmer insurance – Over **14.24 crore insurance covers** have been provided with increased distress relief for crop damage

- Affordable healthcare – Ayushmann Bharat was launched in September 2018 to provide health insurance cover of INR 5 lakh/family/year. In 9 months, over **25 lakh people have received free medical treatment** worth over INR 3,400 crore. The plan is to benefit 50 crore citizens. Maternal and child healthcare has dramatically improved through Mission Indradhanush which **immunized 86.88 lakh pregnant women and 3.38 crore children**. There has been a large decrease in the infant mortality rate and maternal mortality rate. Matru Vandana Yojana provided maternity benefits worth INR 1600 crore to 50 lakh women.

- Clean water – While piped water supply hasn't reached everyone yet, this is one of the first mandates taken up by the NDA-II government

Data from: https://5years.mygov.in/, TRAI March 2019, TRAI 2014, AISHE, Economic Times

Clearly, millions of Indians - especially in rural areas - saw development in action when these basic amenities reached their villages and houses. Working for their upliftment translated into the electorate voting PM Modi back to position for another five-year term - to continue fulfilling his promises. Hopefully, by 2020, all Indians will have access to basic necessities and will have risen out poverty. **The 2019-24 term will be about improving quality of life, investing in growth and the judicial system, ensuring more well-paying jobs are being created, and instituting an environment of safety and security for all Indians**.

India has dramatically changed in the last five years. No longer do Indian voters seem to be moved by caste, religion and other such considerations. PM Modi's move to ban triple talaq reportedly won him 15-20% of the Muslim women's vote. In Assam, a leader of a communal Muslim party said in an interview that he did not get the expected number of MP seats because many Muslim women did not vote for them. **The voters' outlook is fixed on economic prosperity, social justice, and development,** and the numbers establish that PM Modi definitely made an impact by accelerating development and economic prosperity. The Indian people are honest about what they are witnessing and that is why they voted in large numbers for Modi 2.0.

Modi ne kya kiya? The voters answered!

OPINION

TV MOHANDAS PAI &
(Chairman, Aarin Capital Partners)
NISHA HOLLA
(Entrepreneur & independent researcher)

Prime Minister Narendra Modi's resounding victory in the 2019 Lok Sabha election took many by surprise, especially in the Lutyens Media. Several among the opposition asked the rhetorical question, *Modi ne kya kiya*? to cast him in a bad light. They were oblivious to the intense development undertaken by PM Modi that touched millions of citizens, many for the first time.

Some TV interviews feature journalists asking villagers what PM Modi had done to get their votes—*Bolo Modi ne kya kiya tere liye?*—in a blatant attempt to provoke them and get negative answers. However, villagers all over India are emphatic in their response about why they wanted PM Modi back for another five years. They have witnessed the changes through their own eyes. A lot of them have had direct benefits. Interestingly, some of the individuals answering the journalists hadn't received direct benefit themselves but knew someone who had. They enthusiastically said, '*mere padosi ko gas connection mila hai*', '*woh gaon main ab bijli hai*', '*hamne dekha hai*', and most importantly, '*vishwas hai ki hame bhi milega*'. The re-election is testimony to the benefits many Indians have received in the last five years.

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No other prime minister of India has done so much for the poor in one five-year term as PM Modi has. He is ensuring every Indian has access to the basic necessities of life:

- A roof over their head—1.53 crore homes were built post 2014, a majority of them in the rural areas.
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- Power in their switches —100 per cent electrification was achieved in 988 days, covering 17,181 villages, up from around 96.7 per cent in 2014. 2.5 crore poor households were electrified, and the work to provide reliable power continues.
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- Gas connection in the kitchen—13 crore gas connections were distributed in five years, bringing the total to around 25 crore. Of these, 7.19 crore connections have been provided free to rural women, enabling them to cook smoke-free and improving their health dramatically.
- Rural road connectivity—Today, 91 per cent of villages are connected with roads, up from 56 per cent in 2014.
- Access to education—Apart from schools, enrolment in higher education also jumped from 3.23 crore in 2014 to 3.66 crore in 2018. More Indians, including women, are aspiring to become graduates. The Gross Enrolment Ratio of women has risen from 22.0 in 2014 to 25.4 in 2018. It is essential to create suitable jobs for all of them now.
- Mobile phones—TRAI data shows that the wireless subscriber base in March 2019 was 1.16 billion, up from 0.9 billion in 2014. Of this, 511.3 million are in the rural areas. Access to mobiles has transformed how people in the rural areas (and urban) do business and earn a livelihood.
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Clearly, millions of Indians—especially in rural areas—saw development in action when these basic amenities reached their villages and houses. Working for their uplift translated into the electorate voting PM Modi back to position for another five-year term to continue fulfilling his promises. Hopefully, by 2020, all Indians will have access to basic necessities and will have risen out poverty. The 2019-24 term will be about improving quality of life, investing in growth and the judicial system, ensuring more well-paying jobs are created, and instituting an environment of safety and security for all Indians.

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Link: Modi ne kya kiya? The voters answered!

GDP by state: Will the North and South ever meet?

TV Mohandas Pai and Nisha Holla

India's economy has grown at a breathtaking pace, from a nominal GDP of INR 87 lakh crore in 2011-12 to an estimated INR 190 lakh crore in 2018-19. Compound annual growth rate (CAGR) of 11.74% in nominal terms and 7.05% in real terms is remarkable, making India the fastest growing major economy in the world. In 2014-19, the NDA-I government grew the economy by INR 78 lakh crore at a CAGR of 10.88%. While the last quarter of 2018-19 recorded lower growth and the forecast for the next two quarters is also lower, India is expected to retain its status going forward.

While overall growth is impressive, a detailed look shows growth has been uneven across states. GDP data published by RBI of representative states (Table 1) indicates significant variance between the northern and southern states. Southern and Western states from Tamil Nadu till Gujarat are thriving with robust CAGR and impressive per-capita GSDP. In 2017-18, the population-weighted average of **per-capita GSDP for the south was INR 1.93 lakh, 2.5 times that of the north at INR 0.77 lakh**. Even with improved CAGR of over 10% in Madhya Pradesh, Bihar and West Bengal, states in the north are recording low per-capita GSDP. It is clear that growth across India is variant and continues to diverge.

Zone	Per-capita Gross State Domestic Product (INR)			
North - Central	**2011-2012**	**2017-2018**	**CAGR**	**Projected 2027-28**
Uttar Pradesh	35,917	62,291	9.61%	1,55,944
Rajasthan	62,907	1,11,539	10.02%	2,89,717
Madhya Pradesh *	43,082	93,491	13.78%	3,40,054
East				
Jharkhand	45,318	69,534	7.40%	1,41,928
Odisha	54,708	92,726	9.19%	2,23,420
Bihar	23,525	42,242	10.25%	1,12,059
West Bengal	56,693	1,04,750	10.77%	2,91,428
NORTH pop-weighted avg	**42,573**	**77,003**	**10.38%**	**2,06,759**
South	**2011-2012**	**2017-2018**	**CAGR**	**Projected 2027-28**
Tamil Nadu	1,03,600	1,86,125	10.26%	4,94,171
Andhra Pradesh	76,997	1,57,495	12.67%	5,19,106

Telangana	1,00,732	1,98,577	11.98%	6,15,459
Karnataka	98,568	1,99,875	12.50%	6,49,331
West				
Maharashtra	1,13,154	2,05,499	10.46%	5,55,531
Gujarat *	1,01,075	2,00,244	12.07%	6,25,774
SOUTH pop-weighted avg	**1,01,577**	**1,93,902**	**11.38%**	**5,69,593**

Table 1: Per-capita GDP by state. Data from RBI, CAGR computation and projections by authors. (* indicates data not published for 2017-18 in report, calculated from previous data)

For study purposes, we projected the per-capita GSDP of states for ten years using GDP and population CAGR calculated from 2011-2018 data (Table 1). Of course, these projections could change on several factors. Projections indicate that if development and population growth rates of states are equivalent to the last six years, the variance between states could diverge even more. Per-capita GSDP in southern states will have consistently multiplied, contributing massively to India's growth and GDP. It **could be well over INR 5.6 lakh - 2.75 times that of the north average at INR 2.06 lakh**. This is up from a factor of 2.5 in 2017-18, clearly indicating a divergence in growth if special measures to boost these state economies are not taken soon.

Northern states have larger populations and higher population growth rates of 1.42% on average, compared to 1.06% in the south (Table 2). This correlation implies that a large swath of India's population has insufficient income, low contribution to GDP and high population growth rate while a smaller group has very high income, proportionally high contribution to GDP and low population growth rates. **This population-weighted inequality is unsustainable.**

Combined Zones	Pop growth rate	GER	Life expectancy	5-year total – HE graduates
	2011-12 to 2017-18	2017-18	2012-16	2013-2018
North	1.42%	21.1	67.2	1,92,02,177
South	1.06%	34.3	70.6	1,67,16,374

Table 2: Population-weighted averages. Population and life expectancy data from RBI, GER data from AISHE (weighted average calculation by authors)

Further, a major difference between the southern and northern states are the youth populations. Fertility data from NFHS-4 shows the population in the southern states is ageing, whereas the youth bulge in the north and east is still substantial. As discussed in our previous FE article (Demographic distress: Will India get older before it gets richer?) the fertility rates in southern states are all under 1.8 - below replacement. Notable contributors to lower fertility are shown to be better education infrastructure and employment prospects in the south, especially for women. Southern states have significantly larger enrolment ratios in higher education, as discussed in our FE article (Holding up half the sky). The variance in Gross Enrollment Ratio (Table 2) in higher education between southern and northern states on average is a significant 13.2 points in 2017-18. Among the more prosperous south-west states, Gujarat trails with a GER of 20.1 while Tamil Nadu leads with GER of 48.6 in 2017-18.

GER is lower in the north; but in absolute numbers, there is still a significant number of higher education graduates due to the large populations. AISHE data shows that from the representative states discussed above in the north, there have been a five-year total of 1.92 crore graduates from 2013-18 (Table 2). Of this, 92 lakhs are women. Unfortunately, these are in regions where jobs for educated people are the least - most of the specialized jobs requiring graduates are in the south. Without quality employment prospects, educated youth in the north either opt out of the workforce or take up lower level jobs. The PLFS 2017-18 survey shows this is one of the reasons for low workforce participation among women – unemployment among urban women with secondary education or above is at 19.8%, up from around 10% in the NSS-68th round 2011-12. States must prioritize providing educated youth quality employment prospects in their home states.

Above data and trends indicate that growth has been uneven across India. The centralized planning strategy which the Planning Commission has applied all these years before NITI-AAYOG has not worked. One development strategy deployed across India cannot address the inherent differences between states. I**n Modi 2.0, a well-defined state-wise strategy supported by data is required to bring special attention to development in states** that are below the national average, especially in the North and East India.

One of the critical investments to accelerate the development of lagging states is to focus on implementing education infrastructure, for both school and higher education, and then provide the educated youth quality employment prospects in their own states. In particular, instituting labour-intensive industries with intensive skills training in the populous states will provide employment on a large-scale. Madhya Pradesh has already started building labour-intensive industries with positive results. Apart from this, the need of the hour is to build infrastructure, improve governance and deliver services faster in these states.

Strategy must also focus on the strengths of each state and implement policy accordingly. For example, West Bengal can leverage its coastline and industrial legacy to develop into an industrial and trade superpower. Bihar, with abundant fertile land and labour, can focus on becoming a major producer of food and labour-intensive industries as Madhya Pradesh has. With careful planning and implementation, each state in India can be specially developed. In the next five years, **it is essential for Modi 2.0 to create specialized programs with centralized funding to take care of the needs of the underdeveloped states** in the North and East, so they quickly rise up to the current all-India average in terms of human capital.

Variation also exists within each state. In Uttar Pradesh, the planned city of Noida is one of India's most prosperous cities whereas several eastern districts like Chandrauli and Fatehpur have been identified as Backward by NITI-AAYOG. Even within more affluent states like Karnataka, there is considerable variance between districts – the Economic Survey of Karnataka 2018-19 shows that Bengaluru district alone accounts for nearly two-thirds of Karnataka's GDP. As the Centre under PM Modi's able leadership brings focus to each state's development, a closer look at districts can direct policy and allocation decisions.

By accelerating development in lagging states and districts, every state can develop as a superpower in its own right. All of India’s population can then participate in India’s rise as a global superpower. The goal is to take each and every Indian along on our fast-paced journey towards becoming a USD 10 trillion economy.

Link: Will the North and South ever meet?

Featured in: ThePrint

INTER-STATE DISPARITY

THE CENTRALISED PLANNING STRATEGY APPLIED ALL THESE YEARS DID NOT WORK. ONE STRATEGY ACROSS INDIA CANNOT ADDRESS THE INHERENT DIFFERENCES BETWEEN STATES

Will the North and the South ever meet?

TV MOHANDAS PAI & NISHA HOLLA
Chairman, Aarin Capital Partners
Entrepreneur and independent researcher
Views are personal

INDIA'S ECONOMY HAS grown at a breathtaking pace, from a nominal GDP of ₹87 lakh crore in FY12 to an estimated ₹190 lakh crore in FY19. Compound annual growth rate (CAGR) of 11.74% in nominal terms and 7.05% in real terms is remarkable, making India the fastest growing major economy in the world. In 2014-19, the NDA-I government grew the economy by ₹78 lakh crore at a CAGR of 10.88%. While the Q4FY19 recorded lower growth and the forecast for the next two quarters is also lower, India is expected to retain its status going forward.

While overall growth is impressive, a detailed look shows growth has been uneven across states. GDP data published by RBI of representative states (see graphic) indicates significant variance between the northern and southern states. Southern and Western states from Tamil Nadu till Gujarat are thriving with robust CAGR and impressive per-capita GSDP. In FY18, the population-weighted average of per-capita GSDP for the south was ₹1.93 lakh, 2.5 times that of the north at ₹0.77 lakh. Even with improved CAGR of over 10% in Madhya Pradesh, Bihar and West Bengal, states in the north are recording low per-capita GSDP. It is clear that growth across India is variant and continues to diverge.

For study purposes, we projected the per-capita GSDP of states for ten years using GDP and population CAGR calculated from 2011-2018 data (see graphic). Of course, these projections could change on several factors. Projections indicate that if development and population growth rates of states are equivalent to the last six years, the variance between states could diverge even more. Per-capita GSDP in southern states will have consistently multiplied, contributing massively to India's growth and GDP. It could be well over ₹5.6 lakh—2.75 times that of the north's average at ₹2.06 lakh. This is up from a factor of 2.5 in FY18, clearly indicating a divergence in growth if special measures to boost these state economies are not taken soon.

Northern states have larger populations and higher population growth rates of 1.42% on average, compared to 1.06% in the south (see graphic). This correlation implies that a large swath of India's population has insufficient income, low contribution to GDP and high population growth rate, while a smaller group has very high income, proportionally high contribution to GDP and low population growth rates. This population-weighted inequality is unsustainable.

Further, a major difference between the southern and northern states are the youth populations. Fertility data from NFHS-4 shows the population in the southern states is ageing, whereas the youth bulge in the north and east is still substantial. As discussed in our previous *FE* article (*bit.ly/2JM6u4f*) the fertility rates in southern states are all under 1.8. Notable contributors to lower fertility are shown to be better education infrastructure and employment prospects in the south, especially for women. Southern states have significantly larger enrolment ratios in higher education, as discussed in our *FE* article (*bit.ly/2WSFKWq*). The variance in Gross Enrollment Ratio (GER) (see graphic) in higher education between southern and northern states on average is a significant 13.2 points in 2017-18. Among the more prosperous south-west states, Gujarat trails with a GER of 20.1 while Tamil Nadu leads with GER of 48.6 in 2017-18.

GER is lower in the north; but in absolute numbers, there is still a significant number of higher education graduates due to the large populations. AISHE data shows that from the representative states discussed in the north, there have been a five-year total of 1.92 crore graduates from 2013-18—92 lakh are women (see graphic). Unfortunately, these are in regions where jobs for educated people are the least—most of the specialised jobs requiring graduates are in the south. Without quality employment prospects, educated youth in the north either opt out of the workforce or take up lower level jobs. The PLFS 2017-18 survey shows this is one of the reasons for low workforce participation among women—unemployment among urban women with secondary education or above is at 19.8%. States must prioritise providing educated youth quality employment prospects in their home states.

Above data and trends indicate that growth has been uneven across India. The centralised planning strategy which the Planning Commission has applied all these years before NITI-AAYOG has not worked. One development strategy deployed across India cannot address the inherent differences between states. In Modi 2.0, a well-defined state-wise strategy supported by data is required to bring special attention to development in states that are below the national average, especially in the North and East India.

One of the critical investments to accelerate the development of lagging states is to focus on implementing education infrastructure, for both school and higher education, and then provide the educated youth quality employment prospects in their own states. In particular, instituting labour-intensive industries with intensive skills training in the populous states will provide employment on a large-scale. Madhya Pradesh has already started building labour-intensive industries with positive results. Apart from this, the need of the hour is to build infrastructure, improve governance and deliver services faster in these states.

Strategy must also focus on the strengths of each state and implement policy accordingly. For example, West Bengal can leverage its coastline and industrial legacy to develop into an industrial and trade superpower. Bihar, with abundant fertile land and labour, can focus on becoming a major producer of food and labour-intensive industries. With careful planning and implementation, each state in India can be specially developed. In the next five years, it is essential for Modi 2.0 to create specialised programs with centralised funding to take care of the needs of the underdeveloped states in the North and East, so they quickly rise up to the current all-India average in terms of human capital.

Variation also exists within each state. In Uttar Pradesh, the planned city of Noida is one of India's most prosperous cities, whereas several eastern districts like Chandrauli and Fatehpur have been identified as backward by NITI-AAYOG. Even within more affluent states like Karnataka, there is considerable variance between districts—the Economic Survey of Karnataka 2018-19, shows that Bengaluru district alone accounts for nearly two-thirds of Karnataka's GDP. As the Centre under PM Modi's able leadership brings focus to each state's development, a closer look at districts can direct policy and allocation decisions.

Accelerating development in lagging states and districts, can develop every state as a superpower in its own right. All of India's population can then participate in India's rise as a global superpower. The goal is to take each and every Indian along on our fast-paced journey towards becoming a $10 trillion economy.

Per-capita GDP by state (₹)

Zone	2011-12	2017-18	CAGR %	2027-28^
NORTH - CENTRAL				
UP	35,917	62,291	9.61	1,55,944
Rajasthan	62,907	1,11,539	10.02	2,89,717
MP*	43,082	93,491	13.78	3,40,054
EAST				
Jharkhand	45,318	69,534	7.40	1,41,928
Odisha	54,708	92,726	9.19	2,23,420
Bihar	23,525	42,242	10.25	1,12,059
W Bengal	56,693	1,04,750	10.77	2,91,428
North pop-weighted avg	42,573	77,003	10.38	2,06,759

Zone	2011-12	2017-18	CAGR %	2027-28^
SOUTH				
TN	1,03,600	1,86,125	10.26	4,94,171
Andhra	76,997	1,57,495	12.67	5,19,106
Telangana	1,00,732	1,98,577	11.98	6,15,459
Karnataka	98,568	1,99,875	12.50	6,49,331
WEST				
M'rashtra	1,13,154	2,05,499	10.46	5,55,531
Gujarat*	1,01,075	2,00,244	12.07	6,25,774
South pop-weighted avg	1,01,577	1,93,902	11.38	5,69,593

^Projected; Data from RBI, CAGR computation and projections by authors. (* indicates data not published for 2017-18 in report, calculated from previous data)

Population-weighted averages

Combined Zones	Pop growth rate 2011-12 to 2017-18	GER 2017-18	Life expectancy 2012-16	5 year total- HE graduates 2013-2018
North	1.42%	21.1	67.2	1,92,02,177
South	1.06%	34.3	70.6	1,67,16,374

Population and life expectancy data from RBI, GER data from AISHE (weighted average calculation by authors)

Urbanise or Perish

TV Mohandas Pai and Nisha Holla

Development and urbanisation are two sides of the same coin. No society in recent history remained agrarian while adequately providing for its population. Urbanisation aggregates human activity - aggregation leads to specialisation, specialisation to increased productivity; enabling greater availability of goods, delivery of services, increased wages, and job opportunities. **Urban areas are engines of growth in any modern economy**.

China is a shining example of how urbanisation drives economic growth. China rapidly urbanised from 26.4% in 1990 to 59.2% today. The impact is evident in China, where the quality of life and life expectancy have improved dramatically. We can also trace the feedforward effect in China's specialized workforce and productivity improvements – making China a Top 2 economy with nominal GDP of USD 14.1 trillion. In contrast, India is at USD 2.7 trillion, moving towards the target of USD 5 trillion by 2025.

Region	Urban Population %
USA	82.3%
Europe	74.5%
China	59.2%
World	55.3%
Africa	42.5%
India	34.0%

Table 1: Percentage of urban population in representative regions around the world. Data from World Bank

The world on average is at 55.3% urbanisation, whereas India lags at 34% (Table 1). India has been slow to urbanise because of the fixation on being a village-based society. Most planners still look to Gandhiji's sentiments on this topic – '*The future of India lies in its villages*', he said in 1947. This is no longer true - complexity has increased, people's economic needs and aspirations have grown, and it is impossible to supply adequate resources to India's six lakh villages. Keeping India's population in villages while being unable to meet their economic needs has resulted in high inequity.

Rural employment is mostly in agriculture. 42.7% of India's workforce in 2016-17 was engaged in the agriculture sector crawling at a 3.4% growth rate and contributing only 17.3% to the GDP (Table 2). Meanwhile, 57.3% of the workforce was engaged in industry and services growing at 5.5% and 7.6%, respectively. The income differential is very high, the ratio being 1:3:4 for the average wages of dependents on agriculture to industry to services. Left unaddressed, this large group of agricultural dependents will always be condemned to a sub-aspirational existence - with increasing distress and perpetually dependent on subsidies from the Government.

Sector	% GVA	GVA growth rate	Workforce distribution	Per-capita GVA (INR)
Agriculture	17.3%	3.4%	42.7%	41,621
Industry	29.0%	5.5.%	23.8%	1,25,231
Services	53.7%	7.6%	33.5%	1,64,569

Table 2: 2016-17 data comparing agriculture, industry and services sectors in India across share of Gross Value Added, GVA growth rate, workforce distribution and per-capita numbers. Data from RBI, MOSPI and World Bank

Lack of opportunities is also accelerating large-scale internal migration towards India's few urban growth engines - such as Mumbai, Bengaluru, Delhi, Hyderabad, and others. 2011 Census indicates 43,324 uninhabited villages, presumably abandoned due to migration. **People are voting for urban areas with their feet while Government sings the same old romanticised song about India in villages.**

Large cities are reeling under the strain of overpopulation, with problems like inadequate infrastructure, congestion and rocketing living costs. Employment is unable to keep up with the inflow. Due to high costs, it is uncompetitive to set up industries in cities. Without industries to absorb the incoming rural population, they are mostly making low wages as contract labour. Even if they earn higher wages than in their hometowns, they can't keep up with living costs - **resulting in a growing urban population with unfavorable living conditions**. Moreover, because of the policymakers' fixation on villages, **cities aren't allocated enough to develop infrastructure** to handle their rapidly expanding populations. A lose-lose situation all around.

A compelling solution to this unstable situation is the **systematic shift of people from rural to urban areas**. The 2011 census indicates there are 7,933 towns/cities housing 31.16% of the population, with an average population of 47,536. Of these, 465 towns have a population over one lakh and 53 cities, over ten lakhs. On subtracting these, the remaining 7,468 towns must have significantly lesser populations than the 47,536 average. The upcoming 2021 census will inform us of the current situation.

Census data must be used to **suitably identify 4000-5000 smaller towns all over India and develop them to absorb the rural-to-urban shift sustainably**. GoI's Smart Cities initiative has identified 100 cities so far, focusing on roads, solar, water, and control centres. While expanding to 5000 towns, four critical aspects must be incorporated:

1. **Infrastructure and connectivity:** From the planning stage, it is essential to prioritize providing infrastructure like roads and airport access, internet connectivity, and other amenities. **Not only is state-of-the-art infrastructure crucial for quality of life, it also provides the logistical backbone for a productive industrial environment**. Moreover, commissioning large-scale infrastructure development will also boost the construction sector - another means of mass employment. We need strategic investments from both Centre and State Governments in these towns for parallelised infrastructure development.

2. **Labour-intensive industry (LII) clusters:** Creating many LIIs in and around the 5000 towns is the best way to provide gainful employment to the transitioning population. **By focusing on the right type of industries – garments, fabrication, electronics assembly, automobiles, so on – this move will also boost India's export capabilities.** With focused skilling programs, LIIs will offer excellent income opportunities to the incoming population. Even a lower wage than cities will go a long way towards quality of life, especially since living costs are lower in towns. Women, who are not as mobile as men, can also now find employment near their villages and towns, commute and earn a living. Governments, apart from focusing investment here, must also provide incentives for the private sector to create LIIs.

3. **New sustainable technologies:** While urbanisation improves delivery of services, it poses several challenges like congestion, restricted mobility, high waste production, and pollution. These are solved problems, however, in many parts of the world. India must invest in understanding state-of-the-art technologies and implement them. The newly developed towns will have the advantage of getting **sustainable infrastructure - renewables like solar panels and wind turbines, planned tree cover to offset urban spread, water treatment facilities based on phytoremediation and other plant-based technologies, integrated recycling, EV infrastructure, and public transportation with last-mile connectivity** - integrated from the planning stage itself. Older cities will need careful planning to incorporate new technologies into unwieldy city plans.

4. **Planning for capacity:** Indian policymaking has a jaded tradition of planning projects based on latest available data - usually outdated - like the previous census. By the time projects are completed 5-10 years later, they are operationally overloaded. Instead, it is necessary to plan projects for sewage treatment, airports, roads, water supply, and so on with at least a 20-30-year forecast with provisions for future expansion. Again, China paves the way – many major airports have received the go-ahead to build a third runway and increase seating capacity by forecasting the demand to 2030. In parallel, new airports are being commissioned all over the country to provide additional capacity using forecasting beyond 2030.

Rapid urbanization is essential to sustain India's impressive 10-year growth trajectory and meet PM Modi's 2025 economic target of USD 5 trillion. The proposed network of small towns and industry clusters can become India's engine of growth and provide jobs at scale, thus improving overall economic prosperity. Sustainable urbanization can be the force multiplier to mobilize India's potential.

Link: Urbanise or Perish


URBANISE OR PERISH

TO ACHIEVE ITS TARGET OF A $5 TRN ECONOMY BY 2025, INDIA MUST OVERCOME ITS GANDHIAN FIXATION WITH A VILLAGE-BASED SOCIETY AND INVEST IN URBAN INFRA DEVELOPMENT

Urbanisation is key to drive India's growth engines

TV MOHANDAS PAI & NISHA HOLLA

Pai is Chairman, Aarin Capital & Holla is Technology fellow, C-CAMP

Views are personal

DEVELOPMENT AND URBANISATION are two sides of the same coin. No society in recent history remained agrarian while adequately providing for its population. Urbanisation aggregates human activity—aggregation leads to specialisation, specialisation to increased productivity; enabling greater availability of goods, delivery of services, increased wages, and job opportunities. Urban areas are engines of growth in any modern economy.

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A compelling solution to this unstable situation is the systematic shift of people from rural to urban areas. The 2011 census indicates there are 7,933 towns/cities housing 31.16% of the population, with an average population of 47,536. Of these, 465 towns have a population over one lakh and 53 cities, over ten lakh. On subtracting these, the remaining 7,468 towns must have significantly lesser populations than the 47,536 average. The upcoming 2021 census will inform us of the current situation.

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Urbanise India to Eliminate Poverty

TV Mohandas Pai and Nisha Holla

Sustainable urbanization is a powerful tool to mobilize India's potential. The world is at 55.3% urbanization on average, whereas India lags at 34%. A detailed analysis in our previous article (FE, Urbanize or Perish) demonstrates that **keeping a majority of India's population in villages has resulted in high inequity**. India must systematically urbanize and provide mass-employment to its large population in high-growth sectors like industry and services.

The question of whether we can grow enough food with a reduced agriculture workforce is answered by studying other countries. World Bank data shows with only 1.3% workforce in farms, the US produces enough food to feed double its population. In 2017, median farming household income was $75,994, which exceeded the $61,372 US household median. China, with 27% workforce, produces 500mn tons of food every year with less arable land than India. India produces 290mn tons of food with 43% workforce - nearly double. Instead, 20% of the workforce will suffice. **With higher yield and productivity, a smaller agriculture workforce will earn comparable with industry and services.**

The case for urbanization is evident when we examine state-wise data. The table shows urban percentage, per-capita GSDP, higher education Gross Enrolment Ratio (GER), and Total Fertility Rate (TFR) for representative states. GER is an indicator of human capital development; crucial for high-growth sectors like services. TFR indicates whether a population is shrinking or expanding and is vital to policy planning, as discussed in the article (FE, Falling Fertility). Urbanization data, from 2011 census, must be re-examined with the 2021 census. Nevertheless, there is a clear correlation between urbanization and prosperity.

States in the South-West zones are more urbanized, all above the 31% all-India average. These states also have low TFR, considerably below the India average of 2.18. Low fertility and high GER has resulted in better educated, smaller populations that are earning more than their northern counterparts. **Urbanization is driving this trend - urbanization aggregates human activity, enabling specialization and productivity improvements. It boosts economic prosperity**, which reflects in the leading per-capita GSDP figures of these states. In 2011-12, already these states had higher per-capita GSDP – with Andhra Pradesh on the low end at INR 77,000 and Maharashtra with the highest at INR 1.13 lakh. In six years, these figures have doubled.

Tamil Nadu has India's highest GER, at 48.6, and one of the lowest TFRs, at 1.70. In 2011 itself, we can see TN is most urbanized at 48.4%, and GER was already high at 40.0. No other big Indian state attained a GER of 40 even in 2017-18. Rapid urbanization has boosted TN's enrollment in higher education. However, regressive focus on caste politics has taken away from growth. Though TN had the second highest per-capita GSDP in 2011-12, growth is lower compared to states like Karnataka and Telangana, which are driven by services. The TN government must converge on using high GER and urbanization to drive its strong industry legacy and build a large services sector.

Zones		Urban % 2011 Census	Per-capita GDP 2011-12	Per-capita GDP 2017-18	GER 2011-12	GER 2017-18	TFR 2013-15
NORTH-CENTRAL	Uttar Pradesh	22.3%	35,917	62,291	17.4	25.9	2.74
	Rajasthan	24.9%	62,907	1,11,539	18.2	21.7	2.40
	Madhya Pradesh	27.6%	43,082	93,491	18.5	21.2	2.32
	Punjab	37.5%	95,379	1,55,816	23.0	30.3	1.62
EAST	Jharkhand	24.0%	45,318	69,534	9.9	18	2.55
	Odisha	16.7%	54,708	92,726	16.6	22	2.05
	Bihar	11.3%	23,525	42,242	12.5	13	3.41
	West Bengal	31.9%	56,693	1,04,750	13.6	18.7	1.77
SOUTH	Tamil Nadu	48.4%	1,03,600	1,86,125	40.0	48.6	1.70
	Andhra Pradesh	33.4%	76,997	1,57,495	29.9	30.9	1.83
	Telangana	33.4%	1,00,732	1,98,577	29.9	35.7	1.78
	Karnataka	38.7%	98,568	1,99,875	23.8	27.8	1.80
WEST	Maharashtra	45.2%	1,13,154	2,05,499	26.3	31.1	1.87
	Gujarat	42.6%	1,01,075	2,00,244	16.5	20.1	2.03
	All-India	**31.2%**	**72,187**	**1,31,698**	**20.8**	**25.8**	**2.18**

Data for representative Indian states from Census, RBI, AISHE and NFHS-4. Per-capita GDP computation by authors based on RBI data

Karnataka is an intriguing case. With one of the highest per-capita GDPs at INR 2 lakh in 2017-18 and a reasonably high urban percentage at 38%, a reality check indicator is its lower GER of 27.8. Data from RBI and the Economic Survey shows 60% of Karnataka's GDP comes from Bengaluru and the services sector - driven by IT and other technological drivers. As analysed in our article (FE, Where are the jobs?), a majority of the specialized workforce come from elsewhere. Like most southern states, TFR is low; but the state sees significant immigration. Despite its large services sector, by defocusing on human capital, Karnataka's government is placing natives in an unfortunate situation of being unable to compete for the best jobs in their state. Karnataka must focus on urbanization and development of human capital to remedy this, which will further boost the state's impressive growth trajectory.

Gujarat is another unusual case – high urbanization at 43% but low GER of 20.1, lower than the all-India average. Gujarat's steady growth and high per-capita GSDP of INR 2 lakh are driven by its phenomenal industry sector, which accounts for more than half of GVA. High dependency on industry, and not services which contribute only 35% of GVA, means Gujarat's growth will start slowing down when automation and other factors kick in. With a TFR of 2.03, Gujarat's population downturn is not as steep as southern states. Without the development of human capital, Gujarat is in danger of lagging in the future. The answer to this is investing in higher education and building a strong services sector to complement its industry.

Punjab stands out among the northern states. It boasts a high urban percentage - 37.5%, high GER - 30.3 in 2017-18, and one of the lowest TFRs – 1.62. Despite this, Punjab still relies heavily on agriculture; its services and industrial output is lower than southern states. With indicators of high urbanization, high GER and low population growth, Punjab can easily make the transition to a high-growth economy focused on services with the right policies.

Other states in the North-Central-East zones mostly have low urbanization and low GER. The lack of urbanization has resulted in a shortage of industry and services sectors and low per-capita GDP. The populations in these states will keep growing in the foreseeable future, indicated by higher TFRs. Without employment options in high-growth sectors, these large populations cannot rely on agriculture nor industry alone for growth. Services are a must. Uttar Pradesh has a made a valiant effort to develop human capital – GER rose from 17.4 to 25.9 in six years. Now, policies to boost output with labour-intensive industries (LIIs) and services to provide formal employment can increase growth.

Bihar is a troubling case study on the effects of low urbanization and human capital. Only 11.3% of the population is urban. GER is the lowest in India and hardly growing – from 12.5 to 13.0 in six years. Per-capita GSDP is lowest, at INR 42,000 in 2017-18. Despite having fertile land, Bihar's agriculture sector cannot grow because it is disorganized with a large number of dependents. With India's highest TFR - 3.41, Bihar's expanding population is condemned to a sub-aspirational existence due to the state's stagnant economy. Bihar needs special attention from the Centre with focused schemes to organize the agricultural industry, urbanize and educate the masses, and provide mass employment through LIIs. Madhya Pradesh has set a good example here by prioritizing agrarian growth as well as instituting LIIs to provide mass employment.

It is clear that every state – irrespective of prosperity or geographical location – is diverse. We are now in an era where the role of the Centre is increasingly limited, and State spending is growing. Each state must evaluate its economy – workforce distribution, demographics, sectoral contribution, formal employment, higher education and specialization, unique growth drivers – and set a development plan.

Maharashtra CM Fadnavis has taken the lead here by setting a farsighted vision of a $1Tn economy by 2025 to match PM Modi's $5Tn goal. It remains to be seen how Maharashtra will back this vision up with the required policy changes. Similarly, we need **CMs of each state to evaluate and execute a long-term plan and vision for their state**. India can only realize its true potential as a top 3 economy when every state rises out of poverty - and into prosperity - through sustainable urbanization and human capital development.

Link: Urbanise India to eliminate poverty

● URBANISATION DIVIDEND

WITH GROWTH INCREASINGLY DEPENDENT ON STATE SPENDING, INDIA WILL ONLY REALISE ITS ECONOMIC POTENTIAL WHEN STATES URBANISE SUSTAINABLY TO RISE OUT OF POVERTY

Urbanise India to push poverty out

TV MOHANDAS PAI
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Pai is Chairman, Aarin Capital & Holla is Technology fellow, C-CAMP
Views are personal

SUSTAINABLE URBANISATION CAN mobilise India's potential. The world is at 55.3% urbanisation on average, whereas India lags at 34%. A detailed analysis in our previous article (bit.ly/31 9uUCB) demonstrates that keeping a majority of India's population in villages has resulted in high inequity. India must systematically urbanise and provide mass-employment to its large population in high-growth sectors like industry and services.

The question of whether we can grow enough food with a reduced agriculture workforce is answered by studying other countries. World Bank data shows that with only 1.3% of its workforce in farms, the US produces enough food to feed double its population. In 2017, median farming household income was $75,994, which exceeded the $61,372 US household median. China, with 27% of its workforce involved in farming, produces 500 million tonnes of food every year with less arable land than India. India, in comparison, produces 290 million tonnes of food with a 43% agriculture workforce when 20% would suffice. With higher yield and productivity, a smaller agriculture workforce will earn comparably with industry and services.

The case for urbanisation is evident when we examine state-wise data. The accompanying graphic shows urban percentage, per-capita GSDP, higher education Gross Enrolment Ratio (GER), and Total Fertility Rate (TFR) for representative states. GER is an indicator of human capital development; crucial for high-growth sectors like services. TFR indicates whether a population is shrinking or expanding and is vital to policy planning, as discussed in the article (bit.ly/2MdXsLY). Urbanisation data from the 2011 census must be re-examined with the 2021 census. Nevertheless, there is a clear correlation between urbanisation and prosperity.

States in the South-West zones are more urbanised, all above the 31% all-India average. These states also have low TFR, considerably below the national average of 2.18. Low fertility and high GER has resulted in better educated, smaller populations that are earning more than their northern counterparts. Urbanisation is driving this trend—urbanisation aggregates human activity, enabling specialisation and productivity improvements. It boosts economic prosperity, which reflects in the leading per-capita GSDP figures of these states. In 2011-12, already these states had higher per-capita GSDP—with Andhra Pradesh on the low end at ₹77,000 and Maharashtra with the highest at ₹1.13 lakh. In six years, these figures have doubled.

Tamil Nadu (TN) has India's highest GER, at 48.6, and one of the lowest TFRs, at 1.7. In 2011 itself, we can see TN is most urbanised at 48.4%, with an already-high GER of 40. No other big Indian state attained a GER of 40 even in 2017-18. Rapid urbanisation has boosted TN's enrollment in higher education. However, regressive focus on caste politics has taken away from growth. Though TN had the second-highest per-capita GSDP in 2011-12, growth is lower compared to states like Karnataka and Telangana, which are driven by services. The TN government must converge on using high GER and urbanisation to drive its strong industry legacy and build a large services sector.

Karnataka is an intriguing case. With one of the highest per-capita GDPs at ₹2 lakh in 2017-18 and a reasonably high urban percentage at 38%, a reality check indicator is its lower GER of 27.8. Data from RBI and the Economic Survey show 60% of Karnataka's GDP comes from Bengaluru and the services sector—driven by IT and other technological drivers. As analysed in our article (bit.ly/2GAaSh6), a majority of the specialised workforce comes from elsewhere. Like most southern states, TFR is low; but, the state sees significant immigration. Despite its large services sector, by defocusing on human capital, Karnataka's government is placing natives in an unfortunate situation of being unable to compete for the best jobs in their state. Karnataka must focus on urbanisation and development of human capital to remedy this, which will further boost the state's impressive growth trajectory.

Gujarat is another unusual case—high urbanisation at 43% but lower-than-average GER of 20.1. Gujarat's steady growth and high per-capita GSDP of ₹2 lakh are driven by its phenomenal industry sector, which accounts for more than half of GVA. High dependency on industry, and not services, which contribute only 35% of GVA, means Gujarat's growth will start slowing down when automation and other factors kick in. With a TFR of 2.03, Gujarat's population downturn is not as steep as southern states. Without the development of human capital, Gujarat is in danger of lagging in the future. The answer to this is investing in higher education and building a strong services sector to complement its industry.

Punjab stands out among northern states. It boasts a high urban percentage (37.5%), high GER (30.3) in 2017-18, and one of the lowest TFRs (1.62). Despite this, Punjab still relies heavily on agriculture; its services and industrial output is lower than that of southern states. With indicators of high urbanisation, high GER and low population growth, Punjab can easily make the transition to a high-growth economy focused on services, with the right policies.

Other states in the North-Central-East zones mostly have low urbanisation and low GER. The lack of urbanisation has resulted in a shortage of industry and services sectors and low per-capita GDP. The populations in these states will keep growing in the foreseeable future, indicated by higher TFRs. Without employment options in high-growth sectors, these large populations cannot rely on agriculture or industry alone for growth. Services are a must. Uttar Pradesh has made a valiant effort to develop human capital—GER rose from 17.4 to 25.9 in six years. Now, policies to boost output with labour-intensive industries (LIIs) and services to provide formal employment can increase growth.

Bihar is a troubling case study on the effects of low urbanisation and human capital. Only 11.3% of the population is urban. GER is the lowest in India and hardly growing—from 12.5 to 13 in six years. Per-capita GSDP is lowest, at ₹42,000 in 2017-18. Despite having fertile land, Bihar's agriculture sector cannot grow because it is disorganised with a large number of dependents. With India's highest TFR—3.41—Bihar's expanding population is condemned to a sub-aspirational existence due to the state's stagnant economy. Bihar needs special attention from the Centre, with focused schemes to organise the agricultural industry, urbanise and educate the masses, and provide mass employment through LIIs. Madhya Pradesh has set a good example here by prioritising agrarian growth as well as instituting LIIs to provide mass employment.

It is clear that every state—irrespective of prosperity or geographical location—is diverse. We are now in an era where the role of the Centre is increasingly limited, and state spending is growing. Each state must evaluate its economy—workforce distribution, demographics, sectoral contribution, formal employment, higher education and specialisation, unique growth drivers—and set a development plan.

Maharashtra CM Devendra Fadnavis has taken the lead here by setting a far-sighted vision of a $1 trn economy by 2025 to match PM Narendra Modi's $5 trn goal. It remains to be seen how Maharashtra will back this vision up with policy changes. Similarly, we need CMs of each state to evaluate and execute a long-term plan and vision for their state. India can only realise its true potential as a top-three economy when every state rises out of poverty—and into prosperity—through sustainable urbanisation and human capital development.

Zones		Urban %	Per-capita GDP		GER		TFR
		2011 Census	2011-12	2017-18	2011-12	2017-18	2015-16
NORTH-CENTRAL	Uttar Pradesh	22.3%	35,917	69,991	17.4	25.9	2.74
	Rajasthan	24.9%	69,907	1,11,539	18.9	21.7	2.40
	Madhya Pradesh	27.6%	63,082	93,491	18.5	21.2	2.32
	Punjab	37.5%	95,379	1,55,816	23.0	30.3	1.62
EAST	Jharkhand	24.0%	45,318	69,534	9.9	18	2.55
	Odisha	16.7%	56,708	95,736	16.6	22	2.05
	Bihar	11.3%	23,525	42,242	12.5	13	3.41
	West Bengal	31.9%	56,695	1,04,750	13.6	18.7	1.77
SOUTH	Tamil Nadu	48.4%	1,03,600	1,86,125	40.0	48.6	1.70
	Andhra Pradesh	33.4%	76,997	1,57,495	29.9	30.9	1.83
	Telangana	33.4%	1,00,732	1,98,577	29.9	35.7	1.78
	Karnataka	38.7%	98,568	1,99,875	25.8	27.8	1.80
WEST	Maharashtra	45.2%	1,13,154	2,05,499	26.3	31.1	1.87
	Gujarat	42.6%	1,01,075	2,00,244	16.5	20.1	2.03
	All-India	31.2%	72,187	1,31,498	20.8	25.8	2.18

Data for representative Indian states from Census, RBI, AISHE and NFHS-4. Per-capita GDP computation by authors based on RBI data

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Demographic distress: Will India get older before it gets richer?

TV Mohandas Pai and Yash Baid

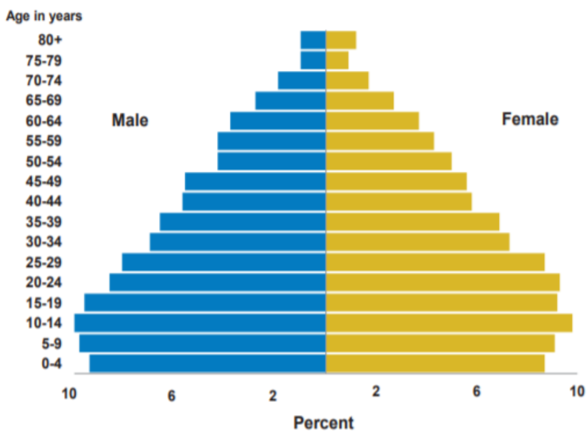
Data from the 4th National Family Health Survey (NFHS-4) 2015-16 for the survey period 2013-15 has signaled a monumental shift in modern Indian demographics. For the first time in its history, India has reached a TFR (Total Fertility Rate) of 2.18, which is below the average world replacement rate of 2.3.

Name	Period	TFR
NFHS-1	1990-92	3.39
NFHS-2	1996-98	2.85
NFHS-3	2003-05	2.68
NFHS-4	2013-15	2.18
Linear trend estimates	Mar-19	~2

For developed countries where the mortality rates of children are low due to higher health standards, the replacement rate is set at 2.1 as per the UN. As the NFHS-4 was conducted back in 2013-15, we followed the trendline of the TFR to determine that **India's TFR will have fallen to about 2.0 by March 2019, well past the developed country replacement rate.** This is shocking and surprising and must be validated in the coming years by NFHS-5 which is being conducted currently.

***Figure 2.4* Population Pyramid**

Percent distribution of the household population



Known for its large population, India is perceived as a country which will benefit from a large demographic dividend. As population growth moves past its peak, we need to be acutely aware that the population of our youth is on the decline. Population growth is past its peak. There are not enough young people coming into India to replace the current population. As can be seen in the population pyramid chart, from NFHS 4, there are fewer babies being born over the last 10 years. The population pyramid has inverted for the first time ever. This rate of decline is only expected to accelerate in the coming years. This does not mean that the country's population has peaked as yet, because improving healthcare beckons improved longevity, which is ushering in a growing population of citizens over the age of 60.

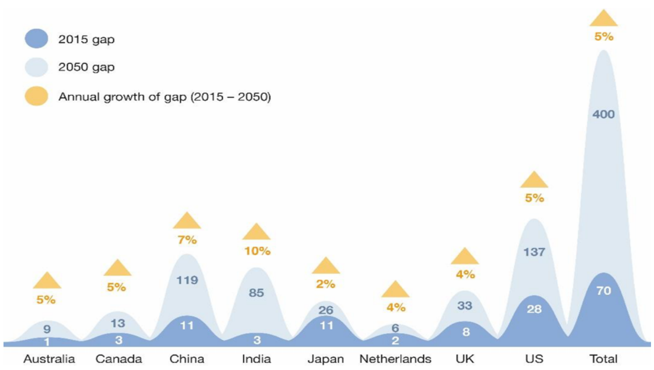
The percentage of children under the age of 15 declined from 35% in NFHS-3 (2003-05) to 29% in NFHS-4 (2013-15). In contrast, the population 60 years and older increased slightly, from 9% in NFHS-3 to 10% in NFHS-4. India is now on the verge of becoming an older country, where we can expect the country's average age to increase over the next few decades.

An important question to be raised here is will India become older before becoming richer? This demographic movement is a monumental event that will significantly shape national policies in the coming decades, necessitating the government to take some difficult decisions.

Will there be enough wealth created by the country's working-class population for the growing segment of longer living senior citizens that will increasingly rely on pensions? China was able to do this to an extent due to their spectacular economic boom over the last couple of decades. Although India's population skew will not happen at the pace at which it did in China, India too will need to move beyond policies for population control and towards building wealth at a brisk pace. Here are a few noteworthy measures the government will need to prioritise -

1. **Increasing women's participation in the workforce** - To bolster the capacity of wealth creation of India's working class, India must tap into the under-utilised working-aged women population. According to a 2018 World Bank report, the labour force participation rate among females in India was 27% in 2018 while the world average stood at 48.5%. According to IMF research, raising women's participation in the labour force to the same level as men can boost India's GDP by 27% and contribute additively to India's GDP growth every year.

2. **Improving social security -** Incentivising investments into retirement schemes like pensions is paramount for India, given its changing demographic profile. Of every 10 Indian workers, 8 are informally employed, with limited access to retirement savings accounts. Further, a growing middle class is witnessing increasing wage rates and an improving quality of life, which will result in increased expectations for retirement income. These dynamics are resulting in what the WEF predicts is the highest growth (10% CAGR) in the retirement savings gap amongst all large-population countries, as India's social security shortfall burgeons from $3T in 2015 to $85T in 2050.



3. **Reimagining education for tomorrow -** Today's job market is vastly different from what it was a decade back. Further, 65% of children joining primary school today will eventually work in a job that does not yet exist. To meet this skills-gap, the education curriculum and delivery across a student's lifecycle requires a significant revamp. There is also an urgent need to reskill a large chunk of population that is stuck in legacy roles. The Government must work towards reskilling workforces in industries where job requirements are expected to alter drastically because of the shift in India's demographics.

4. **Implementing tech-enabled healthcare -** The use of technology in healthcare coverage will be necessitated with a growing older-aged population in India. With a doctor to population density of 1/1700, the country's dearth of quality medical talent is not a predicament that it can soon overcome. Technology can be revolutionary in delivering quality healthcare services in India by improving access, increasing efficiency of diagnosis and care, and further, reducing the cost of healthcare delivery and insurance.

Link: Demographic distress: Will India get older before it gets richer?

● DEMOGRAPHIC DISTRESS

ALTHOUGH INDIA'S POPULATION SKEW WILL NOT HAPPEN AT THE PACE AT WHICH IT DID IN CHINA, IT MUST MOVE BEYOND POPULATION CONTROL POLICIES AND TOWARDS BRISK WEALTH-BUILDING

Will India get older before it gets richer?

TV MOHANDAS PAI & YASH BAID

Pai is Chairman, Aarin Capital Partners and Baid is head of research, Sonek Capital

DATA FROM THE 4th National Family Health Survey (NFHS-4) 2015-16 for the survey period 2013-15 has signaled a monumental shift in modern Indian demographics. For the first time in its history, India has reached a TFR (Total Fertility Rate) of 2.18, which is below the average world replacement rate of 2.3.

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Falling fertility: The myths and reality of India's demographic data

TV Mohandas Pai and Yash Baid

A drop in fertility of a country typically correlates with rising education standards, especially amongst women. Such has been the case here in India as well. The literacy rate for women has gone up to from 55.1% as per NFHS-3 (survey period 2003-05) census to 68.4% as per NFHS-4 (survey period 2013-15), a jump of 24%. During the same period, India's Total Fertility Rate (TFR) came down 18.7% from 2.68 to 2.18.

What is of particular note, is that this trend is seen across religions. Every religious groups has shown a decline in the fertility rate with the Muslim community showing the highest decline. This puts to rest the alarmist rumours of higher birth rates in Muslim households in comparison to Hindu households. The fertility decline for Muslims lags the Hindus but is coming down steeply!

As can be seen in the table below, the literacy rates amongst Muslim women, which was seen to be quite insufficient in NFHS-3, has improved by 30% in the ten years since, outpacing most other religions. During the same period, we can see fertility rates dip in a striking correlation across all religion groups as well. The TFR for Muslims was down by 23%, the largest reduction amongst all large religion groups. The massive fertility declines for the Jains and Sikhs is very worrisome indeed. Are they beyond the limits of sustainability?

Percentage Literate						
Religion	NFHS-3 (2005-06)		NFHS-4 (2015-16)		% Increase since previous NFHS	
	Male	Female	Male	Female	Male	Female
Hindu	78.9	54.9	86.4	68.3	10%	24%
Muslim	70.2	49.5	80.3	64.2	14%	30%
Christian	84.6	75.9	89.4	80.8	6%	6%
Sikh	83.6	71.9	88.3	81.1	6%	13%
Buddhist / Neo-Buddhist	87.3	63.9	94.2	81.1	8%	27%
Jain	99.6	97.1	97.1	97.5	-3%	0%
Other	51.6	29.1	75.1	60.0	46%	106%

Total Fertility Rate			
Religion	NFHS-3 (2005-06)	NFHS-4 (2015-16)	% Decrease since previous NFHS
Hindu	2.59	2.13	18%
Muslim	3.40	2.62	23%

Christian	2.34	1.99	15%
Sikh	1.95	1.58	19%
Buddhist / Neo-Buddhist	2.25	1.74	23%
Jain	1.54	1.20	22%
Other	3.98	2.57	35%

This is a very significant revelation for a nation where policies are often not based on data and opinions are driven by unfounded biases towards religions. India must get in tune with this data and not leave room for speculation and false campaigns. The correlation between literacy and fertility has demonstrated the importance of education in shaping a forward-looking outlook amongst all communities. It is thus obvious that economic backwardness and education of the girl child have significant impact on fertility. The massive increase in education outlays and huge growth in the economy between 2003-05 to 2013-15 has been very beneficial in reducing population growth and the Muslim community has seen the largest decline in fertility. NFHS-5, 2018-19 will be a very interesting study to corroborate how this trend continues as the GDP has seen a huge growth in the last 5 years.

In our previous article in the Financial Express (Demographic distress: Will India get older before it gets richer? Published: May 17, 2019), we had discussed the importance of improving women's participation in the workforce to improve the per capita income of India. To further this cause, women must be encouraged to study beyond primary and secondary education, helping them obtain the skills necessary to find promising work opportunities post-education.

To this effect, we must introduce policies to provide free education till post-graduation for all girls across all communities.

It is just as essential to understand that Centralised models of development cannot hold good in a country like India where each state's population is growing at a widely divergent pace than the others. Social policies for each state must be differentiated to accommodate different rates of population growth. As can be seen in the table below, the populations in south & west India are growing at a much slower pace than in the central and eastern states.

TFR by State					
Region / State	NFHS-3 (2005-06)	NFHS-4 (2015-16)	Region / State	NFHS-3 (2005-06)	NFHS-4 (2015-16)
Central			**West**		
Rajasthan	3.21	2.40	Gujarat	2.42	2.03
Chhattisgarh	2.62	2.23	Maharashtra	2.11	1.87
Madhya Pradesh	3.12	2.32			
Uttar Pradesh	3.82	2.74			

East			South		
Bihar	4.00	3.41	Andhra Pradesh	N/A	1.83
Jharkhand	3.31	2.55	Karnataka	2.07	1.80
Manipur	2.83	2.61	Kerala	1.93	1.56
Meghalaya	3.80	3.04	Tamil Nadu	1.80	1.70
Nagaland	3.74	2.74	Telangana	N/A	1.78

The southern states & Maharashtra are considerably below replacement levels. Kerala may go the way of Japan and South Korea in future where population could actually decline barring immigration there. The difference between such states and the ones in central and eastern India is more than one, i.e. each household in south India adds one less person to India's population than its contemporaries. What this data demonstrates clearly is that the Indian demography cannot have a blanket single status for policy considerations, as state-wise macros of population, education, fertility, per capita income, etc. fall in a wide range.

The southern states have focused on education and social services which has reduced fertility and improved economic development, leading to higher per capita income. Clearly, the Union Government must incentivise the eastern and central states through special allocations to continue and improve the focus on education of the girl child at the secondary and tertiary levels. These states must improve infrastructure to rapidly bring themselves up to an ideal state, perhaps to the benchmarks set by the southern states. The holistic growth of India as a nation requires a more nuanced focus on social policies at the state-level. This will help the country continue the impressive growth it has achieved over the last 15 years.

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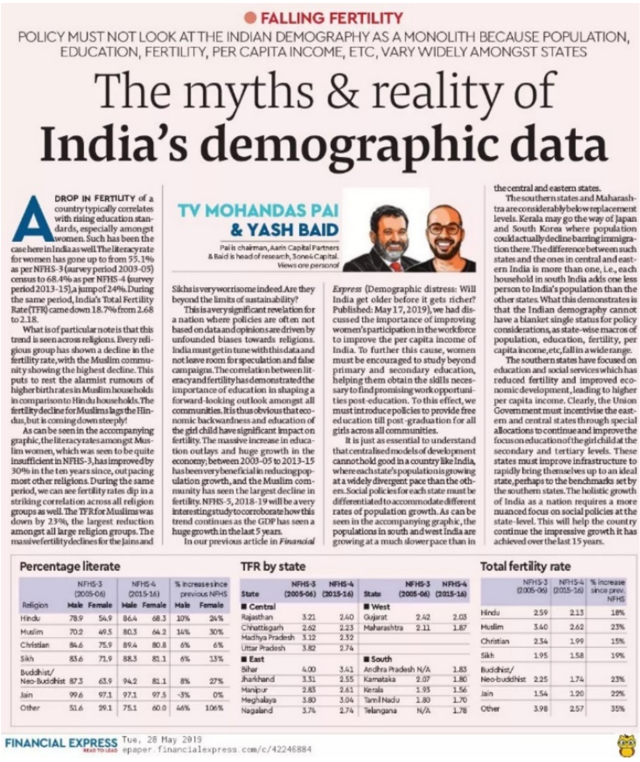

● FALLING FERTILITY

POLICY MUST NOT LOOK AT THE INDIAN DEMOGRAPHY AS A MONOLITH BECAUSE POPULATION, EDUCATION, FERTILITY, PER CAPITA INCOME, ETC, VARY WIDELY AMONGST STATES

The myths & reality of India's demographic data

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Percentage literate

Religion	NFHS-3 (2005-06) Male	NFHS-3 (2005-06) Female	NFHS-4 (2015-16) Male	NFHS-4 (2015-16) Female	% increase since previous NFHS Male	% increase since previous NFHS Female
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Madhya Pradesh	3.12	2.32			
Uttar Pradesh	3.82	2.74			
■ East			■ South		
Bihar	4.00	3.41	Andhra Pradesh	N/A	1.83
Jharkhand	3.31	2.55	Karnataka	2.07	1.80
Manipur	2.83	2.61	Kerala	1.93	1.56
Meghalaya	3.80	3.04	Tamil Nadu	1.80	1.70
Nagaland	3.74	2.74	Telangana	N/A	1.78

Total fertility rate

	NFHS-3 (2005-06)	NFHS-4 (2015-16)	% increase since prev. NFHS
Hindu	2.59	2.13	18%
Muslim	3.40	2.62	23%
Christian	2.34	1.99	15%
Sikh	1.95	1.58	19%
Buddhist/ Neo-buddhist	2.25	1.74	23%
Jain	1.54	1.20	22%
Other	3.98	2.57	35%

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Holding up half the sky

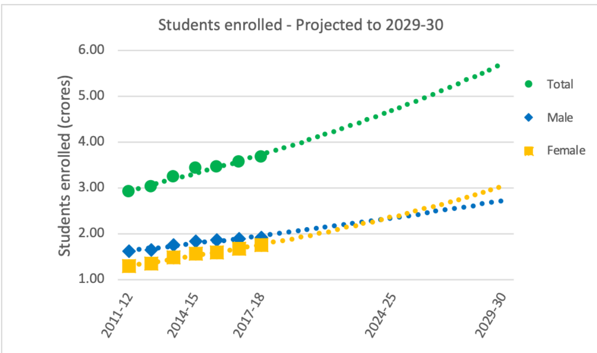
TV Mohandas Pai and Nisha Holla

The National Fertility and Health Survey-4 shows India's fertility rates have dramatically dropped to 2.18, below replacement rate as analyzed in our previous article in Financial Express (Demographic distress: Will India get older before it gets richer?). Demographics are changing across the socio-religious spectrum and are strongly correlated with women's education and literacy, as discussed in our article in Financial Express (Falling fertility: The myths and reality of India's demographic data). We look at women's progress in higher education to further understand this change.

Higher education statistics published by AISHE, MHRD (Table 1) from 2011-12 to 2017-18 shows an increasing trend. Total number of males enrolled increased by 30.3 lakhs, 18.7% in 6 years, while the number of women enrolled **increased by 44.3 lakhs, a whopping 34% rise**. The compound annual growth rate (CAGR) for total enrollment is 3.87%, with males at 2.9% and females at 5%. The percentage of women rose from 44.6% in 2011-12 to 47.6% in 2017-18. More women are pursuing higher education now than ever before.

Year	2011-12	2013-14	2015-16	2017-18
Total	2,91,84,331	3,23,36,234	3,45,84,781	3,66,42,378
Male	1,61,73,473	1,74,95,394	1,85,94,723	1,92,04,675
Female	1,30,10,858	1,48,40,840	1,59,90,058	1,74,37,703
% Female	44.58	45.90	46.23	47.59

Table 1: Year-wise enrollment in higher education in India (data from AISHE, MHRD)



Extrapolating the data out to 2030 (Fig) indicates the number of women pursuing higher education might soon exceed men. 2024-25 could see a normalization between genders, and 2029-30 could see as much as 53% enrollment of women, a dramatic shift. Many countries around the world have undergone this. In the United States, according to official statistics, 56% of undergraduates are women. India is following this trend.

The total Gross Enrollment Ratio (GER) in age 18-23 is steadily increasing from 20.8 in 2011-12 to 25.8 in 2017-18 (Table 2). Male enrollment increased from GER of 22.1 to 26.3, a 19%

increase. Female enrollment rose even faster, with a GER under 20 to 25.4, a significant jump of 30%. **The GER between genders is normalizing**, again indicating that more women are turning towards higher education to improve their livelihood.

Year	2011-12	2013-14	2015-16	2017-18
All Categories	20.8	23	24.5	25.8
Male	22.1	23.9	25.4	26.3
Female	19.4	22	23.5	25.4

Table 2: Gross Enrollment Ratio in higher education in India (data from AISHE, MHRD)

These trends show a **silent revolution** over the last decade, with significant implications on fertility rates and the economy. It would seem that as more women are turning towards higher education and correspondingly better employment opportunities, they are delaying childbirth and having fewer children. **Higher education is one of the contributors to the levelling off of population growth**.

State	2011-12 GER			2017-18 GER		
	Male	Female	Total	Male	Female	Total
Bihar	14	10.8	12.5	14.5	11.5	13
Rajasthan	20.6	15.5	18.2	22.7	20.6	21.7
Uttar Pradesh	17.5	17.2	17.4	25.2	26.7	25.9
Madhya Pradesh	22	14.6	18.5	21.8	20.5	21.2
West Bengal	15.4	11.8	13.6	19.9	17.6	18.7
Gujarat	18.1	14.7	16.5	21.9	18.2	20.1
Karnataka	24.9	22.7	23.8	27.2	28.5	27.8
Maharashtra	28.1	24.3	23.8	32.6	29.5	31.1
Tamil Nadu	43.2	36.8	40	49.1	48.2	48.6
Andhra Pradesh	33.3	26.4	29.9	34.7	27.1	30.9
Telangana	-	-	-	37.1	34.2	35.7
Kerala	17.8	25.6	21.8	32	40.4	36.2

Table 3(a): State-wise GER of representative states in North and South India (data from AISHE, MHRD)

With India's 29 states having diverse economic conditions, variance in state-wise GER is huge. Table 3(a) contains GER of representative states in North and South India for 2011-12 and 2017-18. On average, North Indian states have much lower GER compared to South, and the divergence is increasing. GER also correlates with development - Bihar's GER moved nominally by 0.5 in six years and also trails in development metrics.

North India	Male	Female	Total GER
2011-12	17.64	14.56	16.20
2017-18	21.67	20.47	21.08

South India	Male	Female	Total GER
2011-12	30.72	27.02	28.12
2017-18	35.21	33.69	34.45

Table 3(b): Population-weighted averages in the North and South (data from AISHE, MHRD)

The **population-weighted averages of representative North and South Indian states** are computed in Table 3(b). Significant observations are:

1. Both the North & South GER have progressed significantly in the last decade. North Indian states have progressed by 4.88 points and South Indian states by 6.33 points from 2011-12 to 2017-18.

2. The difference between the Northern and Southern states of India is striking. On average, the GER of South Indian states is ahead of the North Indian states by 13.37 points in 2017-18.

3. Women are progressing faster than men. In North India, the average female GER jumped 5.91 points from 2011-12 to 2017-18, whereas the male GER moved 4.03 points. In South India, the female GER jumped 6.67 points whereas the male GER moved 4.49 points.

The status of women has dramatically increased in India. At the time of Independence, policymakers did not focus on educating women. As a result, household income and India's GDP did not grow as much as it could have. Contrast this with China - with the establishment of the People's Republic of China in 1949, Chairman Mao famously said, 'Women hold up half the sky' and instituted strict policies to educate women. The result is evident today in women's workforce participation, and contribution to China's GDP and outstanding rise as a Top 2 economy. With India's women pursuing higher education in larger numbers, they must be empowered to contribute to the nation's growth. It is opportune for **India to leverage this economic multiplier to its GDP as it sets course to the USD 10 trillion mark**.

The need of the hour today is to provide the educated population with quality employment prospects. These must include incentives for the participation and traction of women in the workforce. Many women in India are primary caregivers of their children and other family members. Employment policies must take these constraints into account so women can have the flexibility to work around their schedules. **Otherwise, well-educated women will have no option but to drop out of the workforce**, which is a loss for everyone - from the individual to her family to the nation.

Fertility survey data indicates there will be fewer young people twenty years from now. This will result in India's workforce shrinking rapidly while supporting an ageing population. **Instead, if more women are incentivized to work, they will contribute to society and the GDP for a long time**, especially given that Indian lifespans and general wellbeing are also increasing.

Policy can also examine which fields women are pursuing more and focus on retention there. **AISHE data shows that for the first time in 2017-18, enrollment in M.B.B.S. had more women**, 50.3%, than men. If workforce participation for women doctors is improved through policy, this could transform India's healthcare system.

The next pertinent question is *'are women in India overtaking men?'* and how to deal with this. In South India, educational institutions are resorting to interesting ways of handling the inversion. For example, some pre-university colleges in Bangalore are applying a higher cut-off percentage for women applicants. While this might not be the fairest way, we certainly see a possibility of a ceiling - say 60% - imposed on women enrollment.

FINANCIAL EXPRESS

ILLUSTRATION: ROHNIT PHORE

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EDUCATING WOMEN

Holding up half the sky

Improving women's higher education is key to

are women. India is following this trend.

The total Gross Enrollment Ratio (GER) in the 18-23 years age group is steadily increasing from 20.8 in 2011-12 to 25.8 in 2017-18. Male enrollment increased from GER of 22.1 to 26.3, a 19% increase. Female enrollment rose even faster, with a GER under 20 to 25.4, a significant jump of 30%. The GER between genders is normalising, again indicating that more women are turning towards higher education to improve their livelihood.

These trends show a silent revolution over the last decade, with significant implications for fertility rates and the economy. It would seem that as more women are turning towards higher education and correspondingly better employment opportunities, they are delaying childbirth and having fewer children. Higher education is one of the contributors to the levelling off of population growth

The data from the AISHE and NFHS surveys indicate that the best investment India can make towards economic prosperity and societal progress is in higher education and employment prospects of women.

Link: Holding Up Half The Sky

Demography is Destiny

HOW DEMOGRAPHIC UNDERCURRENTS ARE SHIFTING GLOBAL GROWTH

TV Mohandas Pai and Nisha Holla

The world is experiencing unprecedented demographic change and the topic occupies center-stage in many countries. Global population growth rate reduced from 2% in 1970 to 1.1% in 2018. On average, the population is ageing; and rather steeply across the developed world. The fastest growth is now seen mostly in Africa due to higher fertility rates.

Japan is a classic case of an ageing country where the number of yearly births is significantly lower than the number of deaths. World Bank data shows Japan's population growth rate deteriorated from a dismal 0.05% in 2008 to a negative 0.2% in 2018. Median age is around 47 years, and the ratio of older people to the working-age population is the world's highest.

Fertility has dramatically reduced in developed regions like the United States, Europe and Russia. The US fertility rate is now 1.8 births per woman, down from 3+ in 1964, and less than the replacement rate of 2.1. Population growth decreased from 0.95% in 2008 to 0.62% in 2018. Their population is ageing, with a median age at 38 years as opposed to 28 in 1970. Meanwhile, Russia's growth rate has been hovering around 0% for over two decades. The developed world is getting older and shrinking. The biggest challenges are now in managing an ageing society with implications in social security benefits, hospices and healthcare, workforce productivity, automation, accelerated obsolescence, and many other factors.

The geopolitical repercussions of population decline in the developed world are becoming increasingly mainstage. Immigration is changing the ethnic make-up of many countries in Europe and the United States. Different communities have different fertility rates; typically, immigrating groups produce more children than native - mostly white - populations in these regions. In the US, fertility rates amongst the white community average 1.7, while the Hispanic community averages 2.2. The white community is estimated to dip below 50% of the population by 2045, while the Hispanic community might reach 25% up from 17% in 2018.

Apart from other ramifications, the question of skills among communities is foremost. Historically, the immigrant Hispanic community does not have the same skill level as the white community, so this issue bleeds into economic productivity and growth of the nation. With the steep rise in non-white politicians - especially in the neo-socialist extreme left-wing cliques in the Democratic Party exemplified by "The Squad" - demographic change is bleeding into politics as well.

Closer home, China - the world's most populous country - is witnessing a colossal shift. The population growth rate has stabilized at around 0.5% over the last decade, and the number of babies born in 2018 was only 15.23 million – the lowest since the 1961 famine. Median age is 37 years compared to 19 years in 1970. Like the developed world, China also now faces issues like a shrinking workforce and an ageing population.

India's fertility has dropped dramatically. Data from the National Fertility and Health Survey (NFHS) shows India's Total Fertility Rate (TFR) decreased from 3.39 in 1990-92 (NFHS-1) to 2.18 in 2013-15 (NFHS-4). This means already in 2015, we were below the average global replacement rate at 2.3. Previous articles by authors Pai and Baid (FE, Falling fertility) project that India's TFR will fall just under 2.0 in 2019. Following the linear trend projection indicates TFR in India might be as low as 1.86 in 2021.

“Demographics is truly a nation’s destiny. The US took 50+ years to stabilize from a fertility rate of 3+ to 1.8. China took under two decades due to the forced enactment of the One-Child Policy. India is achieving this drop in three decades without any extreme interventions. It is remarkable that a country the size of India is achieving this organically. Policymakers must study the effect of liberalization on our demographics; it cannot be a coincidence that fertility dropped steeply from 3.4 in 1992 to 2.18 in 2015 after liberalization in 1991."

To examine this trend from another angle, there is a wealth of data in the Civil Registration System (CRS). CRS maintains a database of the number of registered births and deaths in the country, and state-wise. The latest CRS report based on 2017 data marks the level of registration of births at 85% and of deaths at 80%. With this, we can estimate the number of births and deaths per year, and the population growth barring immigration. Table 1 contains yearly net additional population since 2011, with actual data up to 2017 and trend projections for 2019 and 2021.

Year	**Annual net population growth (# Births) - (# Deaths)**
2011	1,76,05,572
2013	1,76,68,973
2015	1,80,05,244
2017	1,79,10,455
2019*	1,79,25,000
2021*	1,79,50,000

Table 1: Net population growth per year using births and deaths data from CRS, * indicates projections made by authors

With the addition of annual net populations based on CRS data, the projection for 2021 comes close to 139 crores, as shown in Table 2. The data-backed model also predicts that decadal growth and growth rates for 2011-21 will fall steeper than the previous decades. The upcoming 2021 census will cast more light on this.

Decadal growth reached its zenith in the 1991-2001 decade, with an increase of 18.23 crores, up from 16.31 crores in 1981-91. In 2001-11, decadal growth stabilized to 18.21 crores, slightly fewer than the previous decade. CRS data shows decadal growth is expected to reduce in the 2011-21 decade to roughly 17.8 crores.

Decadal growth rate, on the other hand, peaked back in 1961-70 at 24.8%, and has steadily decreased ever since; which means the population has been growing slower and slower after 1971. Growth slowly reduced to 21.5% in 1991-2001, and then rapidly dropped to 17.7% in 2001-11. With the population projection based on CRS data, it looks like decadal growth rate might plummet to 14.7% in this decade. Without a doubt, India's population is ageing.

Year	**1951**	**1961**	**1971**	**1981**	**1991**	**2001**	**2011**	**2021***
Population	36.11	43.92	54.82	68.33	84.64	102.87	121.09	138.93
Decadal growth	-	7.81	10.89	13.52	16.31	18.23	18.21	17.84
Dec. growth rt.	-	21.64%	24.80%	24.66%	23.87%	21.54%	17.70%	14.73%

Table 2: Census data for 1951-2011, * indicates projections made by authors based on CRS data

The future of all communities lies in its children. India was always pegged as the recipient of the demographic dividend, but data shows we will soon lose that advantage. Table 3 shows the number of children between the ages of 0 and 6 years in the census years 1991 to 2011. This number rose from 150 million in 1991 to 164 million in 2001, then dropped to 159 million in 2011. Projections from the CRS data indicate in 2021, India will have around 156 million children, a drop of 3 million from 2011.

Census	Population (in millions)		% Children of Total
	Age 0-6 yrs	All ages	
1991	150.4	846.4	17.8%
2001	163.8	1028.7	15.9%
2011	158.8	1210.9	13.1%
2021*	156.0	1389.3	11.2%

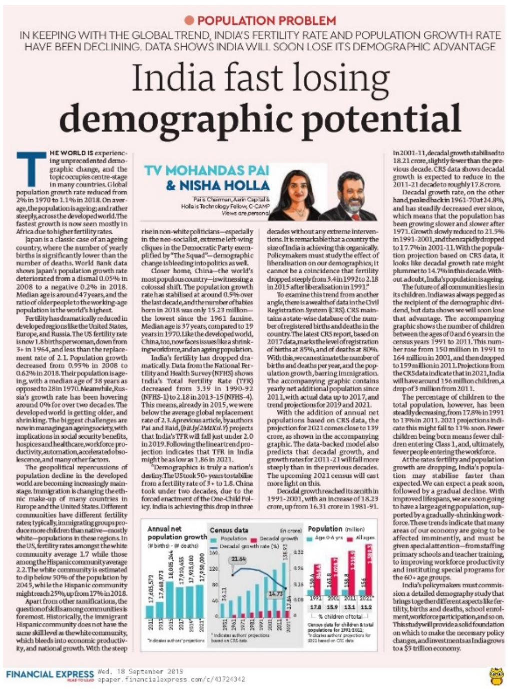
Table 3: Census data for children and total populations for 1991-2011, * indicates projections made by authors for 2021 based on CRS data

The percentage of children to the total population, however, has been steadily decreasing from 17.8% in 1991 to 13% in 2011. 2021 projections indicate this ratio might fall to 11% soon. Fewer children being born means fewer children entering Class 1, and ultimately fewer people entering the workforce.

At the rates fertility and population growth are dropping, India's population may stabilize faster than expected. We can expect a peak soon, followed by a gradual decline. With improved lifespans, we are soon going to have a large ageing population supported by a gradually shrinking workforce. These trends indicate that many areas of our economy are going to be affected imminently and must be given special attention – from staffing primary schools and teacher training, to improving workforce productivity and instituting special programs for the 60+ age groups.

India's policymakers must commission a detailed demography study and bring together different aspects like fertility, births and deaths, school enrollment, higher education GER, workforce participation, and so on. This study will provide a solid foundation on which to make the necessary policy changes and investments as India grows to a $5 trillion economy.

Link: India fast losing its demographic potential


POPULATION PROBLEM

IN KEEPING WITH THE GLOBAL TREND, INDIA'S FERTILITY RATE AND POPULATION GROWTH RATE HAVE BEEN DECLINING. DATA SHOWS INDIA WILL SOON LOSE ITS DEMOGRAPHIC ADVANTAGE

India fast losing **demographic potential**

TV MOHANDAS PAI & NISHA HOLLA

India’s youth need better policies to reap demographic dividend

TV Mohandas Pai and Nisha Holla

India is on a formidable growth trajectory since liberalization in 1991. In nominal terms, the economy has grown from USD 275 billion in 1991 to USD 2.7 trillion in 2019 at a CAGR of 8.5%. In the short term, there is an urgent need to fix the liquidity crisis that has caused an economic slowdown. In the long term - having taken care of most basic necessities - India is undoubtedly in nation-building mode. Understanding how our demographics is changing is more important than ever now to plan this.

Over the last twenty years, India has achieved ~100% enrollment in primary school. Table 1 shows number of children enrolled and Gross Enrollment Ratios (GER) in primary school. GER is the ratio of children enrolled in a particular class to the eligible population in the age group for that class; ages 6-10 for primary school. The prominent rise of midday meal schemes since 2000 has contributed towards higher enrollment.

Number of children enrolled in primary school | Age 6-10					
Year	**Number (crore)**	**GER**	**Year**	**Number (crore)**	**GER**
1960-61	3.50	62.4	2010-11	13.47	115.5
1980-81	7.38	80.5	2011-12	13.98	106.5
2000-01	11.38	95.7	2012-13	13.48	106.0
2005-06	13.21	109.4	2013-14	13.24	101.4
2007-08	13.55	114.0	2014-15	13.05	100.1
2009-10	13.36	113.8	2015-16	12.91	99.2

Table 1: Number of children enrolled in primary school with GER, data from MHRD

GER can go over 100, as it has most years since 2001, when children outside ages 6-10 enroll in primary school. 100+ GERs indicate many older students, who probably missed out on the opportunity to study at that age, are joining school to get an education now. 100+ GERs could also indicate some students are failing to move into secondary school and are being held back. GER rose up to 115.5 at peak in 2010-11, indicating 15.5% more children enrolled apart from those in the age bracket of 6-10 across India. It has since reduced to ~100.0.

With ~100% enrollment achieved, it is interesting to note that the number of children enrolled in primary school peaked at 13.98 crore in 2011-12 and has since steadily decreased to 12.91 crore in 2015-16. This decline corroborates census data that the percentage of children in the population has reduced from 18% in 1991 to 13% in 2011 and may decline to 11% in 2021, as analyzed in our previous article (FE, India fast losing demographic potential).

MHRD data indicates that of the 100 children entering Class 1, ~80 move onto Class 10 where ~79% pass, and 56 enter Class 12 where ~78% pass the State and Central Boards. Indications from MHRD’s large database tracking 13 crore children are at odds with surveys by NGOs like Pratham that use thin surveys of 5.5 lakh rural students to suggest that, for example, only

27% of children in Class 8 can read Class 2-appropriate text. Policymakers must use MHRD's massive database with comprehensive examination pass data to understand quality of students – both urban and rural – and take steps to improve.

After Class 12, the number of youngsters entering higher education drops further - AISHE data indicates GER in 2018-19 was 26.3 across India. AISHE also uses the information from its surveys to estimate the population in the ages of 18-23, the eligible ages for higher education. Table 2 indicates this number has hardly grown from 14.03 crore in 2011 to 14.2 crore in 2018; translating to a CAGR of only 0.18%. Low CAGR in this age group is a clear indication that our workforce size will stagnate soon.

Year	Age 18-23 population
2011	14,03,17,069
2012	14,05,58,699
2014	14,10,45,558
2016	14,15,37,252
2018	14,20,78,501
CAGR	0.18%

Table 2: Age 18-23 population in India, data from AISHE

With number of children in India reducing and the 18-23 population hardly growing, soon India may have an ageing population supported by a shrinking workforce. Today, however, we have an incredible advantage - we are the youngest of the large economies. Median age here is 28 years, compared to 32 in Brazil, 37 in China, 38 in the US, 40 in the UK, and 47 in Japan. Having such a large young population is an irreplaceable opportunity India must take advantage of before it is too late.

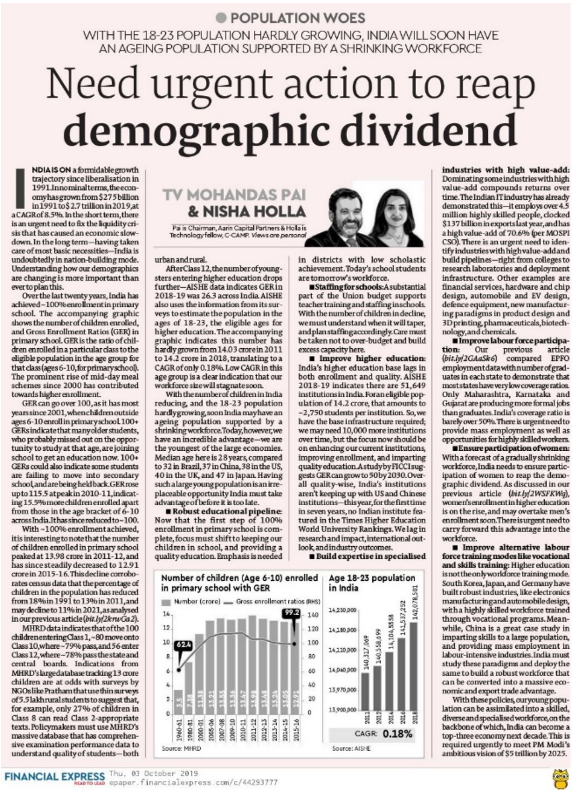
1. **Robust educational pipeline**: Now that the first step of 100% enrollment in primary school is complete, focus must shift to keeping our children in school and providing a quality education. Emphasis is needed in districts with low scholastic achievement. Today's school students are tomorrow's workforce.
2. **Staffing for schools**: A substantial part of the union budget supports teacher training and staffing in schools. With number of children in decline, we must understand when it will taper and plan staffing accordingly. Care must be taken not to over-budget and build excess capacity here.
3. **Improve higher education**: India's higher education base lags in both enrollment and quality. AISHE 2018-19 indicates there are 51,649 institutions in India. For an eligible population of 14.2 crores, that amounts to ~2,750 students per institution. So, we have the base infrastructure required; we may need 10,000 more institutions over time, but the focus now should be on enhancing our current institutions, improving enrollment and imparting quality education. A study by FICCI suggests GER can grow to 50 by 2030. Overall quality-wise, India's institutions aren't keeping up with US and Chinese institutions – this year, for the first time in seven years, no Indian institute featured in the Times Higher Education (THE) World University Rankings. We lag in research and impact, international outlook, and industry outcomes.
4. **Build expertise in specialized industries with high value-add:** Dominating some industries with high value-add compounds returns over time. The Indian IT industry

has already demonstrated this – it employs over 4.5 million highly skilled people, clocked USD 137 billion in exports last year, and has a high value add of 70.6% (per MOSPI CSO). There is urgent need to identify industries with high value-add and build pipelines - right from colleges to research laboratories and deployment infrastructure. Other examples are financial services, hardware and chip design, automobile and EV design, defense equipment, new manufacturing paradigms in product design and 3D printing, pharmaceuticals, biotechnology, and chemicals.

5. **Improve labour force participation**: Our previous article ([FE, Where are the jobs?]) compared EPFO employment data with number of graduates in each state to demonstrate that most states have very low coverage ratios. Only Maharashtra, Karnataka and Gujarat are producing more formal jobs than graduates. India's coverage ratio is barely over 50%. There is urgent need to provide mass employment as well as opportunities for highly skilled workers.
6. **Ensure participation of women:** With a forecast of a gradually shrinking workforce, India needs to ensure participation of women to reap the demographic dividend. As discussed in our previous article ([FE, Holding up the sky]), women enrollment in higher education is on the rise and may overtake men enrollment soon. There is urgent need to carry forward this advantage into the workforce.
7. **Improve alternative labour force training modes like vocational and skills training**: Higher education is not the only workforce training mode. South Korea, Japan and Germany have built robust industries like electronics manufacturing and automobile design with a highly skilled workforce trained through vocational programs. Meanwhile, China is a great case study in imparting skills to a large population and providing mass employment in labour-intensive industries. India must study these paradigms and deploy the same to build a robust workforce that can be converted into a massive economic and export trade advantage.

With these policies, our young population can be assimilated into a skilled, diverse and specialized workforce – on the backbone of which India can become a Top 3 economy next decade. This is required urgently to meet PM Modi's ambitious vision of USD 5 trillion by 2025.

Link: Need Urgent Action to Reap Demographic Dividend



● POPULATION WOES

WITH THE 18-23 POPULATION HARDLY GROWING, INDIA WILL SOON HAVE AN AGEING POPULATION SUPPORTED BY A SHRINKING WORKFORCE

Need urgent action to reap demographic dividend

TV MOHANDAS PAI & NISHA HOLLA

Pai is Chairman, Aarin Capital Partners & Holla is Technology fellow, C-CAMP. Views are personal

INDIA IS ON a formidable growth trajectory since liberalisation in 1991. In nominal terms, the economy has grown from $275 billion in 1991 to $2.7 trillion in 2019, at a CAGR of 8.5%. In the short term, there is an urgent need to fix the liquidity crisis that has caused an economic slowdown. In the long term—having taken care of most basic necessities—India is undoubtedly in nation-building mode. Understanding how our demographics are changing is more important than ever to plan this.

Over the last twenty years, India has achieved ~100% enrollment in primary school. The accompanying graphic shows the number of children enrolled, and Gross Enrollment Ratios (GER) in primary school. GER is the ratio of children enrolled in a particular class to the eligible population in the age group for that class (ages 6-10, for primary school). The prominent rise of mid-day meal schemes since 2000 has contributed towards higher enrollment.

GER can go over 100, as it has most years since 2001, when children outside ages 6-10 enroll in primary school. 100+ GERs indicate that many older students, who probably missed out on the opportunity to study at that age, are joining school to get an education now. 100+ GERs could also indicate some students are failing to move into secondary school, and are being held back. GER rose up to 115.5 at peak in 2010-11, indicating 15.5% more children enrolled apart from those in the age bracket of 6-10 across India. It has since reduced to ~100.

With ~100% enrollment achieved, it is interesting to note that the number of children enrolled in primary school peaked at 13.98 crore in 2011-12, and has since steadily decreased to 12.91 crore in 2015-16. This decline corroborates census data that the percentage of children in the population has reduced from 18% in 1991 to 13% in 2011, and may decline to 11% in 2021, as analysed in our previous article (*bit.ly/2krwGa2*).

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After Class 12, the number of youngsters entering higher education drops further—AISHE data indicates GER in 2018-19 was 26.3 across India. AISHE also uses the information from its surveys to estimate the population in the ages of 18-23, the eligible ages for higher education. The accompanying graphic indicates this number has hardly grown from 14.03 crore in 2011 to 14.2 crore in 2018, translating to a CAGR of only 0.18%. Low CAGR in this age group is a clear indication that our workforce size will stagnate soon.

With the number of children in India reducing, and the 18-23 population hardly growing, soon India may have an ageing population supported by a shrinking workforce. Today, however, we have an incredible advantage—we are the youngest of the large economies. Median age here is 28 years, compared to 32 in Brazil, 37 in China, 38 in the US, 40 in the UK, and 47 in Japan. Having such a large young population is an irreplaceable opportunity India must take advantage of before it is too late.

■ **Robust educational pipeline:** Now that the first step of 100% enrollment in primary school is complete, focus must shift to keeping our children in school, and providing a quality education. Emphasis is needed in districts with low scholastic achievement. Today's school students are tomorrow's workforce.

■ **Staffing for schools:** A substantial part of the Union budget supports teacher training and staffing in schools. With the number of children in decline, we must understand when it will taper, and plan staffing accordingly. Care must be taken not to over-budget and build excess capacity here.

■ **Improve higher education:** India's higher education base lags in both enrollment and quality. AISHE 2018-19 indicates there are 51,649 institutions in India. For an eligible population of 14.2 crore, that amounts to ~2,750 students per institution. So, we have the base infrastructure required; we may need 10,000 more institutions over time, but the focus now should be on enhancing our current institutions, improving enrollment, and imparting quality education. A study by FICCI suggests GER can grow to 50 by 2030. Overall quality-wise, India's institutions aren't keeping up with US and Chinese institutions—this year, for the first time in seven years, no Indian institute featured in the Times Higher Education World University Rankings. We lag in research and impact, international outlook, and industry outcomes.

■ **Build expertise in specialised industries with high value-add:** Dominating some industries with high value-add compounds returns over time. The Indian IT industry has already demonstrated this—it employs over 4.5 million highly skilled people, clocked $137 billion in exports last year, and has a high value-add of 70.6% (per MOSPI CSO). There is an urgent need to identify industries with high value-add and build pipelines—right from colleges to research laboratories and deployment infrastructure. Other examples are financial services, hardware and chip design, automobile and EV design, defence equipment, new manufacturing paradigms in product design and 3D printing, pharmaceuticals, biotechnology, and chemicals.

■ **Improve labour force participation:** Our previous article (*bit.ly/2GAaSk6*) compared EPFO employment data with number of graduates in each state to demonstrate that most states have very low coverage ratios. Only Maharashtra, Karnataka and Gujarat are producing more formal jobs than graduates. India's coverage ratio is barely over 50%. There is urgent need to provide mass employment as well as opportunities for highly skilled workers.

■ **Ensure participation of women:** With a forecast of a gradually shrinking workforce, India needs to ensure participation of women to reap the demographic dividend. As discussed in our previous article (*bit.ly/2WSFKWg*), women's enrollment in higher education is on the rise, and may overtake men's enrollment soon. There is urgent need to carry forward this advantage into the workforce.

■ **Improve alternative labour force training modes like vocational and skills training:** Higher education is not the only workforce training mode. South Korea, Japan, and Germany have built robust industries, like electronics manufacturing and automobile design, with a highly skilled workforce trained through vocational programs. Meanwhile, China is a great case study in imparting skills to a large population, and providing mass employment in labour-intensive industries. India must study these paradigms and deploy the same to build a robust workforce that can be converted into a massive economic and export trade advantage.

With these policies, our young population can be assimilated into a skilled, diverse and specialised workforce, on the backbone of which, India can become a top-three economy next decade. This is required urgently to meet PM Modi's ambitious vision of $5 trillion by 2025.

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Rise of the Indian woman: Historical shift in higher education

TV Mohandas Pai and Nisha Holla

Every year since 2012, MHRD compiles and presents data on India's higher education (HE) base through its AISHE reports – All India Statistics for Higher Education. The recently released 2018-19 report affirms India's rapid progression towards higher enrollment and inclusion. By harnessing this correctly, we can develop our human capital to accelerate economic growth.

Total enrolment in HE in 2018-19 was 3.74 crore, with 1.92 crore men and 1.82 crore women, as shown in Table 1. Since 2011-12, enrolment has increased by 82.2 lakh at 3.6% CAGR, with 30.4 lakh men at 2.5% CAGR and 51.8 lakh women at an incredible 4.9% CAGR. Women enrolment is rising faster; latest data buttresses our previous analysis (FE, Holding up half the sky) demonstrating that women are increasingly turning toward HE with clearer aspirations.

Enrolment	2011-12	2015-16	2018-19	7yr CAGR	3yr CAGR
				Base: 2011-12	Base: 2015-16
Total	2,91,84,331	3,45,84,781	3,73,99,388	3.6%	2.6%
Male	1,61,73,473	1,85,94,723	1,92,09,888	2.5%	1.1%
Female	1,30,10,858	1,59,90,058	1,81,89,500	4.9%	4.4%
% Female	44.6%	46.2%	48.6%	-	-

Table 1: Higher education enrollment, data from AISHE, MHRD

Male enrolment has slowed from a 7-year CAGR of 2.5% to a 3-year CAGR of 1.1%. Between 2017-18 and 2018-19, male enrolment only moved by 5,000 whereas women enrolment rose by 7.5 lakh. Women enrolment has also slowed from a 7-year CAGR of 4.9% to a 3-year CAGR of 4.4% but is nevertheless encouraging. Women are now 48.6% of enrolled students, up from 44.6% in 2011-12. The Gender Parity Index reached 1.0 for the first time, having risen from 0.88 in 2011-12. Female Gross Enrolment Ratio (GER) jumped from 19.4 in 2011-12 to 25.4 in 2017-18 and then by another whole point in 2018-19 to 26.4. **This is the first year that the all-India female GER has risen above male GER, which stagnated at 26.3.**

How is it that even though women enrolment in absolute numbers is lesser than men enrolment, female GER is higher? GER is calculated as the ratio of students enrolled to the eligible 18-23 age – in which there are fewer women, at 48.6%, than men. Interestingly, in the seven years between 2011-12 and 2018-19, the number of women in the eligible 18-23 age population increased from 6.7 crore to 6.9 crore whereas the number of men decreased from 7.33 crore to 7.3 crore. These dynamics combined with the rapid increase in women enrolment is yielding a female GER that is overtaking male GER. **The 2020-30 decade will see the rise of the Indian Woman**; as more educated women join the workforce.

Focus on expansion and quality

The number of registered HE institutions has risen from 49,964 in 2017-18 to 51,649 in 2018-19. AISHE estimates the eligible 18-23-year-old population was 14.2 crore in 2018-19. FICCI's Higher Education report indicates GER could rise to 50.0 by 2030. Today, GER of

50.0 indicates a potential capacity of ~1,375 students/institution. Instead, because GER is only 26.3, average enrolment is 693/college. For now, India has adequate base infrastructure for rapid brownfield expansion, which is easier, quicker and more effective. **The need of the hour is to expand and enhance our current institutions and improve quality of education and GER**.

Graduates need follow-on employment opportunities

Total number of graduates who completed their course in 2018-19 is 90.9 lakhs, up from 89.7 lakhs in 2017-18. Tamil Nadu has India's highest GER at 49.0, and third highest number of graduates at 8.64 lakh. Bihar's GER is among the lowest in the country, at 13.6 barely up from 12.0 in 2011-12. It produced 3.81 lakh graduates, only 4% of India's total. If Bihar with such a large population and high fertility rates does not focus on human capital development, it is a demographic disaster in the making.

Uttar Pradesh has the highest number of graduates – 15.3 lakhs amounting to 16.8% of the total. The state has been the highest producer of graduates every year. Moreover, more than half the graduates are women! Providing these graduates with gainful employment in the state will greatly boost UP's economy.

Periodic Labour Force Survey (PLFS) 2017-18 is reporting labour force participation rate (LFPR) in the 15-29 age group as 16.4% for women and 58.8% for men; down from 24.4% and 63.6% respectively in 2011-12. By extrapolating AISHE data for the 18-23 age population to the 15-29 bracket (with a factor of three to adjust for the 5- to 15-year window), we arrive at rough estimates of the 15-29 population for 2011-12 and 2017-18 as shown in Table 2. The corresponding LFPR indicate that approximately 14 crore men and 4.9 crore women were in the workforce in 2011-12, which dropped to 12.9 crore and 3.4 crore respectively in 2017-18 – a drop of 1.09 crore men and 1.52 crore women. In the same time period, AISHE data shows college enrolment rising from 1.62 crore men and 1.3 crore women in 2011-12 to 1.92 crore men and 1.74 crore women in 2017-18 – an increase of 30.3 lakh men and 44.3 lakh women.

Year	LFPR (15-29 years)		(18-23) age population		Estimated workforce in 15-29 bracket*		AISHE enrolment	
	Men	Women	Men	Women	Men	Women	Men	Women
2011-12	63.6%	24.4%	7,33,33,306	6,69,83,763	13,99,19,948	4,90,32,115	1,61,73,473	1,30,10,858
2017-18	58.8%	16.4%	7,31,21,283	6,87,08,245	12,89,85,943	3,38,04,457	1,92,04,675	1,74,37,703
Delta	-	-	-2,12,023	17,24,482	-1,09,34,005	-1,52,27,658	30,31,202	44,26,845

Table 2: Correlation of workforce to higher education enrolment, data from PLFS, AISHE (*calculated by authors as LFPR x (18-23) popn. x 3)

PLFS must consider that the 15-29 years' workforce could have seemingly shrunk because more are in school and college. In the 18-23 bracket alone, AISHE data demonstrates increased enrollment year-on-year in colleges. MHRD data shows enrolment in secondary school and pre-university is also increasing, which means more children in the 15-18 age bracket are in school. Putting the two together, more than half of the 15-29 age bracket surveyed by PLFS are increasingly in school/college, which could account for the perceived drop in workforce participation. Secondly, after receiving an education, many women do not get employment opportunities in their home states. On average, men are more mobile than women and are able to move elsewhere in search of skilled work. Both these counts could explain the increase in unemployment rates among women as reported by PLFS. Today, PLFS is only conducted across 1.02 lakh households; there is need to expand the sample size while also considering education as a factor for perceived non-participation in the workforce.

Affirmative action yields results

Table 3 compares population composition with enrollment in HE. The 2011 census provides composition of all groups except OBCs, which we obtain from NSSO. The upcoming 2021 census will provide updates. Percentage of SC, ST and OBC groups in HE rose from 12.8%, 4.4% and 31.2% respectively in 2012-13 to 14.9%, 5.5% and 36.3% respectively in 2018-19 – all moving close to their population compositions at 16.6%, 8.6% and 41% respectively. Minorities have not demonstrated the same progress; while their population is 20.2%, their HE representation has only moved from 6% in 2012-13 to 7.6% in 2018-19.

Group	Population %	AISHE Enrolment % of total		Change in absolute numbers
	2011	2012-13	2018-19	(lakh)
SC	16.6%	12.8%	14.9%	17.19
ST	8.6%	4.4%	5.5%	7.47
OBC*	40.9%	31.2%	36.3%	41.76
Minorities	20.2%	6.0%	7.6%	10.11
Remaining population (general merit)	13.6%	45.6%	35.7%	-4.06
Total	100.0%	100.0%	100.0%	72.47

Table 3: Population data from census 2011, *OBC population from NSSO

Government's focus on HE has benefitted previously disadvantaged classes who have developed dramatically. Representation from the population designated 'general merit' is regressing. Between 2012-13 and 2018-19, other groups increased by 17.2 lakh (SC), 7.5 lakh (ST), 41.8 lakh (OBC), and 10.1 lakh (minorities), while the 'general merit' enrolment decreased by 4 lakhs – from 45.6% representation to 35.7% in six years. **NDA-II was probably responding to this decline when they instituted the 10% EWS reservation** to support low-income families in the general category.

AISHE 2018-19 clearly indicates aspirations are on the rise. We have enough capacity to get bullish on increasing enrolment and improving access to high quality education. We must build on the momentum to push this through to the peak of human capital development as India rises.

Link: Rise of the Indian woman: Historical shift in higher education

ILLUSTRATION: ROHNIT PHORE

TV MOHANDAS PAI
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Pai is Chairman, Aarin Capital Partners and Holla is Technology Fellow, C-CAMP. Views are personal

● THE RISE OF THE INDIAN WOMAN

Historical shift in higher education

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NDA 2.0: Historic Mandate and a Renewed Mission

TV Mohandas Pai

As of writing this article, the SENSEX was north of 40,000, NIFTY had breached 12,000 and the NDA crossed 300 seats as per the latest count. The statistically inclined will show that the sway of the markets closely followed the reports of the PM Modi's government's fortunes: rising with reports of a strong performance and ebbing when a majority seemed distant. With the exit poll rally and the current surge in the markets, it's evident that the markets are enthusiastic about the prospect of a stable government and policies geared towards reducing friction and increasing growth.

From being part of the "Fragile Five" in 2014, India has emerged as the bulwark of global financial growth, overtaking even China in terms of GDP growth. With the ongoing trade wars between US and China, slowdown in Europe and fears of another recession, India should move quickly to capitalise on this chance to assert itself as a 5 trillion-dollar economy by 2023 and a 10 trillion-dollar economy by 2030.

One of the engines of this growth is going to be startups and increasing trends of digitisation. India has seen the rise of over 40,000 startups who have created more than 130 billion dollars of value from January 2014 to September 2018. With around 35 unicorns (billion-dollar startups), India is the third largest startup ecosystem in the world in terms of value and numbers, behind China and the US. These startups help create new markets, export revenue and jobs – crucial elements of growth for any economy. The Startup India mission has bought this to the forefront and with this new government, India needs to build on this momentum and nurture these companies so that they can hold their own against other global players. Companies like Oyo have made great strides in China while Ola has opened up in London and Australia, showing that Indian startups, like our tech giants, create world-class products and services that can cater to the next 6 billion coming onto the digital economy.

The Indian government has spent the last few years creating the economic infrastructure to capitalise on such an opportunity: it has cleaned up the NPA build-up in our banking system, created an effective bankruptcy framework to give more power to the lenders, made it easier to do business and created a national tax framework to ensure ease of movement of goods and services. With this, the accumulated Aegean Stables of economic detritus can be cleaned out and fresh capital and credit needs to flow once again to maintain this momentum.

Technology will play a keep part in this transition and the current government also understands the same. The BJP's manifesto also makes numerous references to the application of technology to agriculture, animal husbandry, manufacturing, healthcare and governance. Ayushman Bharat can only achieve its aim if it can apply low-cost technological advancements in primary healthcare centres, thus reducing the burden on hospitals. Schemes like Bharat Net, digital land title and digital governance initiative can help increase connectivity and reduce friction between citizens and the government apparatus, thus helping alleviate chances of corruption or leakage in the system.

India's growth model of leveraging technology to solve the problems of scale can become a template for the emerging world. Schemes like Aadhar, UPI, DBT have yielded grand efficiencies to the Indian economic system and have bought in crores of Indians into the formal system where they can get access to credit and government benefits without any interim leakage. India's soft-power diplomacy can benefit vastly by sharing this knowledge with other nations worldwide and creating international frameworks that are tailored to the emerging economy and startups are poised to be the perfect ambassadors for this. A standard refrain has been that Silicon Valley can create solutions for the first billion, but India can create solutions for the next 6 billion people.

When the celebrations ebb, the new government will need to move swiftly to begin implementation of all these schemes. With this new mandate and a clear majority, this is the best chance for India to consolidate the progress made over the past few years and create the framework of growth to accelerate India to a 10 trillion-dollar economy by 2030.

How to get 10% of India to participate in the Capital Markets

TV Mohandas Pai and Siddarth M Pai

To understand India, you must first understand her past.

1986 saw the launch of the SENSEX. Coined by Deepak Mohoni, the index was created with 1979 as the base year and served as the market barometer ever since. In those days, trading was onerous and the entire turnover of the market over a year now constitutes a day's worth of trades. The 1990s witnessed the SENSEX hovering around the 5000s and was punctuated by several scams, the most infamous being the ones by Harshad Mehta and Ketan Parekh. But with heightened regulation came better governance and confidence in the Indian growth story. This is best exemplified by the SENSEX's growth to 20,000 in 2008 and 40,000 in 2019. Overall, Indian equities have yielded a CAGR of over 16% in rupee terms from its base year till 2019 when measured by the SENSEX.

Yet while India has benefited from a healthy stock market, Indians by and large have not. India has a household savings rate of around 30%, yet the bulk of this money is still routed to the same assets for the past 40 years: FDs, gold and real estate. In spite of Indian equities outperforming all 3 asset classes, India witnessed retail participation of only 25 million people in FY 2016, out of a total population of 1300 million people. This 2% participation meant that India was at the mercy of foreign capital inflows in the form of Foreign Institutional Investors (FIIs) and Foreign Portfolio Investors (FPIs). As a testament to the sway foreign capital had in the country, the Indian markets would ebb and flow purely on the basis of FII outflows and inflows. Even our lawmakers were cognizant of this and drafted regulations to cater to their needs. This is best manifested in income tax with all securities held by FIIs being unequivocally classified as "capital assets" and subject to capital gains, while Indian investors run the risk of it being classified as stock-in-trade and subject to tax as "income from business and profession" instead of capital gains.

Yet this changed since November 2016. The demonetisation exercise, which saw the erstwhile rupee 500 and 1000 notes being denotified in one day, saw crores of rupees flood into the Indian markets. This converged with the rise of fintech startups with a no-broking model which fulfilled KYC norms on the back of India Stack, the combination of Jan Dhan bank accounts, Aadhar for KYC and cheap mobile phones and data packs. This cocktail of events – of digitisation and demonetisation – constituted the greatest fillip to domestic equity participation the likes of which India had never witnessed before. In 2018, while FIIs were net sellers to the tune of Rs. 340 billion, DII or Domestic Institutional Investors, were net buyers of more than Rs. 1090 billion. A prime example of this is February 6, 2018, when India introduced long term capital gains on listed equities. February 6 witnessed the Sensex crashing 1,275 points and Nifty over 300 points intraday. FIIs pulled out Rs 2,326 crore from the Indian market whereas DIIs bought in Rs 1,699 crore. This shows the bulwark of domestic capital against the "hot money" of FPIs.

Mutual funds by far represent the bulk of Indian retail participation in the stock market. As per AMFI (Association of Mutual Funds of India), the average assets under management for May 2019 stood at 25.94 lakh crore, with 8.32 crore folios. This was the culmination of 60 consecutive months of folio growth. Out of this, the number of folios in Equity, Hybrid and Solution Oriented Schemes, wherein the maximum investment is from the retail segment, stood at 7.51 crore. Adjusting for duplicates of around 33%, this translates to around 5Cr individual investors. This represents 3.85% of the population and 6.67% of the population that has a bank account (around 75 crore individual bank accounts). India needs far more participation from her populace to democratise the gains that the stock market has generated and will continue to generate.

The Indian government has articulated a vision of becoming a 5 trillion-dollar economy by 2025, with this figuring in the election speeches as well as the President's address to Parliament in June 2019. This implies a growth of at least 12% on nominal terms and requires an investment of $ 100 billion for infrastructure within the same period. For this, the government has suggested a deepening of the debt market, increased minimum public holding from 25% to 35%, easier transfer of treasury bills and government securities between RBI and SEBI depositories, etc. But like demonetisation, India needs bold measures to increase market access and participation amongst its populace. The key drivers for this will be:

1. Digital Access
2. Small ticket sizes
3. Calibrated risk buckets

In this regard, the following steps should be taken:

Create a mutual fund demat ac for every Jan Dhan account holder:

The Jan Dhan scheme, which aimed to ensure that every household has at least one bank account, has witnessed over 36 crore Indian families getting bank accounts, with close to 1 lakh crore balances in those accounts. Along these lines, the government should mandate that a zero charge demat account be opened for every Jan Dhan account holder. Along with this, select high-quality mutual funds with a long lock-in period should be made available to them with small investment tickets ranging from Rs 10 onwards via a SIP. This one access will vastly improve household savings and the lock-in will ensure that the money will be used towards building a retirement corpus via compounding.

Create a 401(K) structure with mutual funds for Indian employees

India should emulate the 401(k) from the US in principle and allow Indian employees to invest part of their salaries into a suite of safe mutual funds (either dividend or growth) with low expense ratio and a lock-in period to match their employment. Allowing a tax deduction (mentioned below) linked to this will further incentivise employee and employer participation in the scheme.

Allow switches between PF and NPS to Mutual Funds with longer lock-ins

By allowing Indians to channel their provident fund or pension scheme amounts to mutual funds (debt and equity) with a similar lock-in to provident funds or pension schemes, India can vastly increase capital market participation from the over 6 crore provident fund holders while ensuring mitigated risk.

Separate tax deductions for investments into mutual funds

Specific mutual funds such as those for retirement or as a substitute for their provident fund or pension scheme should be created and investments into these should qualify for a tax deduction similar to that for the pension scheme. The current practise of placing ELSS (Equity Linked Savings Scheme) in the crowded 80C bucket should be done away with in favour of a separate category.

Allow for credit against a Mutual Fund portfolio

With the above schemes, it is imperative that credit lines be established against one's mutual fund portfolio to ensure that investors do not have to redeem their funds for emergencies. This will be especially helpful to the Jan Dhan Mutual Fund holders to ensure security along with equity participation.

Create investor education programmes in schools and at the *gram panchayat* level

One of the reasons for the low level of capital market participation is the lack of awareness of this product across India. Most investor camps are concentrated in urban areas, whereas rural participation is imperative in order to democratise our capital markets. Vernacular content along with leveraging the postal system will deepen access of these products.

Along with this, schools should have sessions on taxes and investing from class 8 onwards so that students can become comfortable with the idea of investing in a young age and can educate their parents on the same.

India is unique amongst developing nations to have strong financial markets with a deep history in financial products and yet it paradoxically has the lowest retail participation in these markets. Equities as a percentage of household wealth is a mere 6% for India, compared to 44% in the US and 48% in Hong Kong. A phased manner of introduction of the populace into equities via instruments such as ETFs and mutual funds will allow for the much-needed deepening of the capital markets of India for Indians and by Indians.

India should aim to become a 5 trillion-dollar economy by 2025 and have at least 15 crore people as participants in the capital markets. The greatest growth story the world has witnessed should have Indians as active participants, not as mute spectators.

Link: How to get 10% of Indians to participate in capital markets

PM Modi 2.0: The Startup Prime Minister

Siddarth M Pai

With over 350 seats estimated for Prime Minister Modi's government, Prime Minister Modi is poised to make history as the third Prime Minister in Indian history to come back for a second term with the sole mandate. The markets rejoiced at this news, with the SENSEX soaring past 40,000 and the NIFTY breaching 12,000; news anchors and psephologists dissected every single moment from the lead up to this and entrepreneurs – entrepreneurs are eagerly awaiting the next iteration of Startup India.

India has seen the rise of over 40,000 startups who have created more than 130 billion dollars of value from January 2014 to September 2018. With around 35 unicorns (billion-dollar startups), India is the third largest startup ecosystem in the world in terms of value and numbers, behind China and the US. The Startup India scheme has played a significant role in galvanising entrepreneurial spirit and easing the compliance burden faced by startups in India. Never before have so many governments, regulators and corporates crafted specific initiatives around early-stage businesses.

The Angel Tax, the *bete noire* of all entrepreneurs, was finally quelled with notifications from DPIIT and CBDT providing much needed relief to startups and investors in India. The ability to start a business within 2 days, raise capital from India and overseas, lower cost of IP protection, amongst others, have made it easier than ever to start a business in India.
But these initiatives were centred around reducing the existing compliance burden. What the next iteration of Startup India requires is specific policies geared towards making our Startups globally competitive.

We've witnessed the rise of global Indian startups – with Oyo gaining ground in China and Japan and Ola beginning ops in London and Australia. But to ensure that these become the norm and not the exception, India needs changes to the existing FEMA framework to allow smaller startups to start accessing global markets in a more efficient manner. The ability to send and receive money, create foreign vehicles and joint ventures and raise foreign debt with lower interest rates are crucial ingredients for this.
Even with access to capital and credit, Indian entrepreneurs always need to rely on equity – the costliest form of capital, to finance their operations. Access to credit will be imperative as consecutive and frequent capital raises dilute founders to single digit holdings within a few years. The new Seed Startup Fund of Rs 20,0000 should dedicate at least 25% of its corpus towards credit lines for Indian startups.

In order to galvanise domestic pools of capitals, incentives along the lines of the SEIS scheme in the UK need to be implemented with tax credits for domestic investors. Even the capital gains rate needs to be rationalised to 10% along the lines of the sale of listed shares. Since startup shares are illiquid and significantly riskier, this will go a great way in increasing domestic participation in the Indian startup story. No startup ecosystem has succeeded without deep domestic participation. Over 90% of all funding into Indian startups comes from non-domestic sources and this needs to be reversed.

Other structural issues such as ESOP taxation, which is unfairly geared against startup employees, needs to be revised. Dual-voting shares, stock to advisors, operational clarifications to the angel tax circular, simplified listing procedures are amongst other policies startups await this term.

Many of the policy statements outlined in the BJP manifesto can be fulfilled by domestic startups – the marriage of agriculture and artificial intelligence, survey and land-mapping technology, tackling cybercrime, making healthcare more accessible, are already problems which Indian startups are addressing. Even the India Stack, whose elements of Aadhar, UPI, digilocker, etc are gaining traction from several emerging market countries the world over. If Silicon Valley created the digital ecosystem of the first billion people, India can create it for the remaining 6 billion people worldwide.

From the ramparts of the Red Fort in 2016, Prime Minister Modi bought startups to the national forefront when he declared that "*Hindustan mein koi aisa zila na ho, aisa block na ho jahan koi startup na shuru ho. Start up India, Stand Up India*.

Now, Indian startups eagerly await what their most prominent supporter will do for them next.

Link: Modi is the startup Prime Minister

DVR: A Difference, but not enough Change

Siddarth M Pai

As a financial instrument, shares have two entwined characteristics: one of control and the other of economic benefits. Both these characteristics usually rank parri-passu and any change in one necessitates a change in the other to maintain that balance. It is the flexibility to cleave these rights that have allowed for unique structures which have unlocked greater shareholder value the likes of which have never been seen before, like Facebook, Google (now Alphabet), Snapchat and Ali Baba.

The acceptance of DVRs (differential voting rights) by SEBI yesterday was supposed to herald this revolution for India's digital companies. But sadly, the regulatory baggage it is saddled it will hamper the potential of this initiative.

India has had DVRs since 2000 with 5 listed companies opting for this such as Tata Motors, Pantaloons Retail, Jain Irrigation, etc. In all these cases, the shares that had differential (inferior) voting rights always had an extra coupon or an economic inducement for compensate for the lack of control, thus respecting the principle stated previously. But this all changed in 2009 with the case of *Anand Pershad Jaiswal and Ors v. Jagatjit Industries Ltd. and Ors,* wherein an issue of DVRs caused someone with a 32% economic interest to wield 62% control of the Company. With this case, SEBI acted swiftly and sent a letter to all stock exchanges prohibiting the issue of DVRs, thus ending India's brief affair with this.

If 2009 saw India shed DVRs, it also saw Facebook embrace it with open arms. The dual-class structure instituted by Facebook in 2009 allowed Mark Zuckerberg, who held 22% of Facebook, to control 57% of the voting rights in the Company at the time of IPO. Facebook IPO in 2012 saw them debut with a peak capitalisation of $ 104 billion and now has a market cap of $ 543 billion.

It's important to acknowledge that the reality digital businesses inhabit differs from traditional business or *India Inc.* Digital business and startups chase growth instead of profits initially and raise multiple rounds of capital to achieve this. As such the holding of the promoters or founders isn't the 50-60% that promoters of Indian Inc held in the olden days – they're in the low teens or even single digits. The Flipkart promoters held around 8% of the company together at the point of exit. It is this reality which necessitates DVRs to ensure that promoters of tech companies can still direct the company as per their vision.

The best blueprint for DVRs in India would be to follow the US model – wherein liquidity of these DVRs is limited and their economic rights are mitigated in favour of the preferential voting rights that they enjoy. The restrictions of the net-worth of the promoter group, the mandatory sunset clause impede the attractiveness of this. We must acknowledge that Indian tech IPOs have lagged the rest of the world. The large blockbuster tech IPO people can recollect is that of Mindtree, which has seen itself engulfed by L&T in a hostile takeover. Having DVRs without these restrictions may have prevented this from happening. Even

Subroto Bagchi acknowledged this on a panel last Friday where he said that SEBI's current construct wouldn't have aided their case.

The protections SEBI proposed such as a fully independent director-led audit committee and the coat-tail provisions will ensure minority shareholder protection. SEBI has a stellar track record in this field. In the ease of doing business rankings, the highest rank is afforded to the protection of minority shareholder at number 7 in the world and this is due to the efforts of SEBI. But protection should not stifle innovation and regulations should not regress progress but buttress it.

Innovation outstrips regulation but regulation always outsmarts innovation. Between these lies the entrepreneur, like Icarus, who has to rise but keep in mind not to get too close to the sun and run the risk of getting burnt.

Link: DVR a difference, no change

DVR: A difference, not enough change

The acceptance of DVRs by SEBI was supposed to herald a revolution for India's digital companies. But sadly, the regulatory baggage it is saddled with, will hamper the potential of this initiative

SIDDARTH PAI

Founding partner, 3one4 capital
Views are personal

AS A FINANCIAL instrument, shares have two entwined characteristics: one of control and the other of economic benefits. Both these characteristics usually rank parri-passu and any change in one, necessitates a change in the other to maintain that balance. It is the flexibility to cleave these rights that have allowed for unique structures which have unlocked greater shareholder value, the likes of which have never been seen before, like Facebook, Google (now Alphabet), Snapchat and Ali Baba.

The acceptance of differential voting rights (DVRs) by SEBI yesterday was supposed to herald this revolution for India's digital companies. But sadly, the regulatory baggage it is saddled with will hamper the potential of this initiative.

India has had DVRs since 2000 with 5 listed companies, such as Tata Motors, Pantaloons Retail, Jain Irrigation, etc, opting for this. In all these cases, the shares that had differential (inferior) voting rights always had an extra coupon or an economic inducement to compensate for the lack of control, thus respecting the principle stated previously. But all this changed in 2009, with the case of *Anand Pershad Jaiswal and Ors v. Jagatjit Industries Ltd. and Ors*, wherein an issue of DVRs caused someone with a 32% economic interest to wield 62% control of the company. With this case, SEBI acted swiftly and sent a letter to all stock exchanges prohibiting the issuing of DVRs, thus ending India's brief affair with them.

If 2009 saw India shed DVRs, it also saw Facebook embrace it with open arms. The dual-class structure instituted by Facebook in 2009 allowed Mark Zuckerberg, who held 22% of Facebook, to control 57% of the voting rights in the company at the time of IPO. Facebook IPO, in 2012, saw them debut with a peak capitalisation of $104 billion and now has a market cap of $543 billion.

It is important to acknowledge that the reality digital businesses inhabit differs from traditional business or India Inc. Digital businesses and startups chase growth instead of profits initially, and raise multiple rounds of capital to achieve this. As such, the holding of the promoters or founders isn't the 50-60% that promoters of India Inc held in the olden days—they're in the low teens or even single digits. The Flipkart promoters held around 8% of the company together at the point of exit. It is this reality which necessitates DVRs to ensure that promoters of tech companies can still direct the company as per their vision.

It is important to acknowledge that the reality digital businesses inhabit differs from traditional business or India Inc. Digital businesses and startups chase growth instead of profits initially

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The protections SEBI proposed, such as a fully independent director-led audit committee and the coat-tail provisions, will ensure minority shareholder protection. SEBI has a stellar track-record in this field. In the ease of doing business rankings, India's best showing, at number seven in the world, is in protection of minority shareholder and this is due to the efforts of SEBI. But protection should not stifle innovation, and regulations should not regress progress, but buttress it.

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For the Want of Liquidity, a Slowdown is Born

T.V. Mohandas Pai & Siddarth M Pai

Choked by water but starved of liquidity – if there's one phrase that can sum up India's predicament today, it would be this. India's GDP growth has been driven by consumption and credit has been the lynchpin to this. In India, credit is the *de jure* realm of banks but the *de facto* business of the Non-Banking Finance Companies (NBFCs). The seeds of this slowdown lie in the NBFC crisis and the subsequent drying up of credit, which has hobbled consumption.

Indian banks were reeling under a mountain of NPAs – peaking at 11.5% gross of all advances made by the banking system as of March 31st, 2018. As banks became cautious, NBFCs picked up the slack and drove access to credit for all consumers, bolstered by technology, public deposits, FMPs, NCDs and their ability to refinance their loans from Mutual Funds and other credit lines. But all this came to a head in September 2019 with India's Lehman moment – the IL&FS default of over 1,500 Crore.

The IL&FS crisis in September 2019 was supposed to be India's Lehman moment – the default heard around the world which sent shivers down India's economic spine. But the warning signs were evident as early as June 2019 with a default Rs 450 Crore of inter-corporate deposits. The September 2019 default lead to a snowball effect throughout the entire NBFC financing ecosystem. Provisioning for the over Rs 91,000Cr debt extended to IL&FS; debt mutual funds saw the worth of their investment shrink by over 10% in 4 months; corporate bond issuances saw yields sky-rocket and these issuances declined over 13% during the first nine months of 2018-19 as per a CARE report; credit rating agencies rushed to downgrade various issues and people pulled money out of the market until the storm died down. The pain felt by the investors was immediate, but the bleeding effect on consumers was just beginning.

Consumer lending is Indian has been driven by the NBFCs, who contributed over 40% of all consumer finance in the country. Consumers looking to make high-value purchases like cars, two-wheelers, housing consumer durables, houses etc seldom do this fully out of their own savings – they have increasingly relied on NBFCs for credit. The lending parameters of banks aren't geared towards uncredited borrowers who are slowly entering the formal economy, leading to the rise of the NBFCs as a means to quench this credit demand. But in spite of the apparent riskiness of these borrowers, NBFCs have historically had lower NPAs than banks since the loan amount and tenure of these retail loans are lower than the wholesale credit offered by banks. But NBFCs rely on the credit markets in order to function and any evaporation of credit cripples the entire economy.

NBFCs as a business are not the creators of credit – they are facilitators of it. They function as intermediaries between banks, investors and savers- the storehouse of credit, and borrowers – whose consumption drives economic growth. NBFCs are beholden to their Net Interest Margin or NIMs – the spread between their cost of borrowings and their yield from lending. NBFCs also need rely on the ability to refinance their own borrowings to avoid an asset-liability mismatch – where the returns from their loans leant out aren't enough to service their own borrowings. This unholy trifecta – the inability to obtain credit from banks and investors, lowering NIMs due to higher borrowing costs and an asset-liability mismatch has caused them to scale back heavily on new loans while simultaneously liquidating their assets in order to generate liquidity to finance their own obligations.

It is this key issue that's at the root of the current slowdown in India.

The timing of the NBFC crisis was also inopportune, causing the crisis to balloon to what it has become. The IL&FS crisis evolved at a time when then honourable finance minister was under ill-health during its first quarter and Parliament went into its budget session with an interim finance minister during the second quarter. The next quarter saw the nation gripped by the elections and the fourth quarter after IL&FS marked the new budget session of Parliament. This exacerbated the situation since strong policies were the need of the hour and though systemic liquidity was high, thanks to the bank capitalisation exercises undertaken and the lowering of the repo rate – but these rate cuts were not transmitted to the end borrowers and lending to the end-consumer didn't rise fast enough to fill the gap left by the NBFCs. RBI should have studied the flow of credit to the consumer as opposed to only looking at systemic liquidity – for what good is money in the system if consumers can't borrow?

Measures to alleviate this liquidity crisis is to ensure more credit reaches the end consumer. The securitisation of existing NBFCs loans and the Rs 1 trillion partial credit guarantee scheme to PSBs will inject liquidity into NBFCs, but this is the substitution of AA-rated assets for cash – not a fresh injection of liquidity. This will allow the NBFCs to retire some of their debt and will not increase credit to the end-consumer. Injecting fresh funds into the PSBs will not translate to higher credit extended to the customers since the money goes into dealing with their legacy NPA issues and into wholesale lending, not retail lending. Over the past five years, the government has infused over Rs. 2.5 lakh crore into the public sector banks, but as of today, their market cap is only Rs. 2.3 lakh crore. These investments have not yielded the liquidity that Indian consumers crave.

NBFC credit disbursal to consumers fell 28.2% from March 2019 to June 2019, from Rs 2.49L Crore to Rs. 1.79L Crore. The contraction in the auto industry, the slowdown in construction, the pile-up of housing inventory to 42 months, job loss and drying up of investment – trace back their origin to the lack of liquidity. Paradoxically, the SBI chairman, Mr Rajnish Kumar, said that he has over 1 lakh crore to lend but doesn't have anybody to lend to – while NBFCs have customers but money to lend. A match made in heaven. NBFCs need to be commended for the role they play in enabling credit growth and the step-motherly treatment meted out to them should stop.

To increase liquidity, India needs bold measures. The surcharge rollback on FPIs was only of listed equities and equity funds, not for debt. This is exacerbating the liquidity crunch since the return profile of the returns from such funds has been skewered. The transmission of repo-rate cuts to the end consumer by linking the loans to a benchmark rate will help free up liquidity and lower borrowing costs. Injection into consumer lending companies and accessibility of credit for NBFCs will help spur consumption for the upcoming festival season and revive the falling GDP numbers.

Credit is the fuel of economic growth and the entire slowdown traces itself back to the lack of credit availability to consumers. This Gordian Knot of systemic liquidity but no credit has snowballed into a self-inflicted crisis. It is reminiscent of a poem from the "The Nail" series by DC comics, which begins with the following poem:

For want of a nail the shoe was lost,
for want of a shoe the horse was lost,
for want of a horse the knight was lost,
for want of a knight the battle was lost,
for want of a battle the kingdom was lost.
So a kingdom was lost—all for want of a nail.
For the want of credit, India's path to a $ 5 trillion should not be lost.

Link: For the want of Liquidity, a slowdown is born

For want of liquidity, a slowdown is born

TV MOHANDAS PAI & SIDDARTH PAI

Mohandas Pai is Chairman, Aarin Capital & Siddarth Pai is Founding partner, 3one4 Capital. Views are personal

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Warning signs of the IL&FS crisis were evident as early as June 2019, with a default ₹450 crore of inter-corporate deposits. The September default lead to a snowball effect throughout the entire NBFC financing ecosystem. Provisioning for the over ₹91,000 crore debt extended to IL&FS, debt mutual funds saw the worth of their investment shrink by over 10% in 4 months, corporate bond issuances saw yields sky-rocket, and these issuances declined over 13% during the first nine months of 2018-19, as per a CARE report. Credit rating agencies rushed to downgrade various issues, and people pulled money out of the market until the storm died down. The pain felt by the investors was immediate, but the bleeding effect on consumers was just beginning.

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One measure to alleviate this liquidity crisis is ensuring more credit reaches the end-consumer. The securitisation of existing NBFCs loans and the ₹1 trillion partial credit guarantee scheme to PSBs will inject liquidity into NBFCs, but this is the substitution of AA-rated assets for cash, not a fresh injection of liquidity. This will allow NBFCs to retire some of their debt, and will not increase credit to the end-consumer. Injecting fresh funds into the PSBs will not translate into higher credit extended to customers since the money goes into dealing with their legacy NPA issues, and into wholesale lending, not retail lending. Over the past five years, the government has infused over ₹2.5 lakh crore into PSBs, but, as of today, their market cap is only ₹2.3 lakh crore. These investments have not yielded the liquidity that Indian consumers crave.

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Increasing liquidity, needs bold measures. The surcharge rollback on FPIs was only of listed equities, and equity funds, not for debt. This is exacerbating the liquidity crunch since the profile of the returns from such funds has been skewered. The transmission of repo rate cuts to the end-consumer, by linking loans to a benchmark rate, will help free up liquidity, and lower borrowing costs. Injection into consumer lending companies, and accessibility of credit for NBFCs will help spur consumption for the upcoming festival season, and revive the falling GDP numbers.

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EMPLOYMENT

Where are the jobs?

TV Mohandas Pai and Nisha Holla

The jobs debate rages on. Naysayers and the Delhi Leftist Economic Club claim increasing unemployment. The facts are that India recorded impressive growth between 2014-2019. Nominal GDP grew by an estimated INR 78 lakh crore - 69.2% growth at a CAGR of 10.9% - implausible without a corresponding increase in employment.

Oft quoted surveys like PLFS (Ministry of Labour) and Consumer Pyramids (CMIE) indicate a decline in employment. However, they barely survey 105,000 and 160,000 households, respectively; not statistically representative of 1.35 billion people since the context in which people work has fundamentally changed. Many scholars have also pointed out technical challenges in the surveys. Further, there is significant economic variance among states, and even within states, as shown in our previous article (FE, GDP by state: Will the North and South ever meet?). India's economic composition has also changed dramatically in the last ten years, rendering some survey methodologies outdated. We need new data sampling methodologies, including employment databases, that account for these factors.

It is time policymakers and economy watchers analyze data from sources like EPFO (Employee Provident Fund Organization), ESI (Employee State Insurance), NPS (National Pension Scheme), IT returns, vehicle sales, Mudra scheme, and others. **Steadily, these databases are linking subscribers to Aadhar and can be cross-mapped**. EPFO, ESI and NPS publish monthly reports, with disaggregated data from Sep 2017, and serve as useful starting points.

EPFO applies to entities with 20+ employees across 190 industry classifications. EPFO records new subscribers every month **upon payment of contribution** and classifies them by age group, industry, and state. The latest June 2019 payroll report shows gross number of new EPF subscribers in FY 2018-19 is 1.39 crore (Table 1). Accounting for people who joined and then exited, and in some cases rejoined in the same FY, **net number of new subscribers is 1.12 crore** - representing the net number of people who got a new job during the year.

Age	Net New EPF Subscribers
< 18	1,01,851
18-21	27,77,760
22-25	28,63,278
26-28	13,86,142
29-35	19,99,329
35	21,21,854
Total	**1,12,50,214**
Exc. Formalization	1,00,32,534
Old MOSPI format Total	61,12,223

Table 1 – Net number of new subscribers recorded by EPFO in FY 18-19, by age group

An applicable entity, on crossing the 20-employee mark, is inducted into EPFO. One criticism is that EPFO does not indicate new jobs but only formalization, because existing employees are inducted in this manner. This criticism doesn't hold because we can easily account for this. 60,884 establishments remitted their first electronic challan (ECR) in 2018-19; factoring this by 20 gives us 12.17 lakh new subscribers which are existing employees getting formalized. Subtracting 12.17 lakh from the net number yields just over 1 crore new jobs (Table 1). Further, new employees over the 20-employee minimum of existing entities count as new jobs. EPFO's methodology was recently updated. In the old MOSPI format, the subtraction of exiting employees included those that had joined before the FY started instead of only those who had registered in the FY. Methodology was revised to count the number of exits, as well as those who rejoined in the same FY, correctly. If a person quits and joins a new job, the record must reflect in both columns. With the correction, the net new subscribers excluding formalization are at 1.003 crore.

Of 1.12 crore (Table 1), the highest number is 28.6 lakh in the age bracket of 22-25. A very close second is 27.8 lakh in the 18-21 bracket. In the below-18-years group, the record is 1.01 lakh. The sum of net new subscribers in these three groups, till age 25, is 57.4 lakh. Census data shows over the last 30 years, 2.5 crore babies were born every year on average. With approximately 2.5 crore people attaining the age of 21 every year, of which let us assume 60% look for employment, across levels of education – we arrive at 1.5 crores needing jobs incrementally every year. With a total of 56.4 lakh new subscribers in the 18-25 age bracket, we must look at higher education data to correlate the number of pass-outs from college who enter the job market. A majority in the 18-25 category could have either graduated from high school or progressed substantially in higher education. The 26-28 age bracket recorded 13.9 lakh new subscribers who could either have post-graduate degrees or maybe took a break and started a second job.

Zones	EPFO 2018-19					AISHE 2017-18		Coverage ratio of Age 18-28 jobs to pass-outs %
North-Central	**Age 18-21**	**Age 22-25**	**Age 26-28**	**Age 18-28**	**Total (all ages)**	**GER**	**College Pass-out**	
Uttar Pradesh	1,03,205	68,444	21,601	1,93,250	2,52,773	25.9	17,01,557	11.4%
Rajasthan	66,163	44,997	12,502	1,23,662	1,77,332	21.7	6,86,995	18.0%
Madhya Pradesh	49,644	38,571	16,030	1,04,245	1,42,061	21.2	4,63,449	22.5%
East								
Jharkhand	15,760	14,737	8,008	38,505	55,616	18.0	1,51,724	25.4%
Odisha	17,882	16,129	4,289	38,300	35,489	22.0	2,14,911	17.8%
Bihar	13,167	16,992	12,143	42,302	88,293	13.0	3,76,973	11.2%
West Bengal	73,101	79,502	36,094	1,88,697	2,63,553	18.7	3,85,507	48.9%
South								
Tamil Nadu	2,60,699	1,26,990	26,479	4,14,168	5,02,020	48.6	8,77,008	47.2%
Andhra Pradesh	45,100	36,978	17,495	99,573	1,51,024	30.9	3,85,572	25.8%
Telangana	1,28,393	1,23,214	42,274	2,93,881	4,04,079	35.7	3,19,539	92.0%
Karnataka	2,65,827	2,19,708	53,295	5,38,830	6,18,080	27.8	5,06,839	106.3%
West								
Maharashtra	5,31,060	4,86,518	1,68,034	11,85,612	15,75,943	31.1	8,67,599	136.7%
Gujarat	2,29,793	1,37,373	50,496	4,17,662	5,55,525	20.1	3,55,305	117.6%
All India	**23,42,998**	**17,71,705**	**5,78,759**	**46,93,462**	**61,12,223**	**25.8**	**89,68,546**	**52.3%**

Table 2 – Net new subscribers by age group for representative states in each zone recorded in EPFO in the old MOSPI format, AISHE data from MHRD. Coverage ratio computed by authors. (Odisha's total EPFO number is less than Age 18-28 because data shows a significant number quit in the 35+ age bracket)

Table 2 shows 2018-19 EPFO data, disaggregated by state and age group, correlating with 2017-18 AISHE graduation data. This is the old MOSPI format with new subscribers totaling 61.1 lakh. Applying the corrected methodology across state data might reveal new patterns. India's GER in 2017-18 was 25.8, and 89.6 lakh students graduated in total. These are people who completed college and maybe seeking formal employment. The coverage ratio of new jobs in the 18-28 age bracket in 2018-19 to graduates in 2017-18 is also presented.

In the representative states in the North-Central-East zones, total new subscribers in the 18-28 age bracket were 7.3 lakh while the number of college pass-outs is nearly 40 lakhs. Uttar Pradesh is a significant contributor here – it has an impressive GER of 25.9 and 17 lakh graduates – but the coverage ratio is only 11.4%. States like Bihar, Jharkhand and Rajasthan have low GER and low coverage ratios. West Bengal has a higher coverage ratio, 49%, but low GER of 18.7, which must be improved along with formal job creation.

Even in the more industrialized South-West, some states are unable to provide formal employment on par with graduation rates. Tamil Nadu, with India's highest GER at 48.6, has a coverage ratio of 47% while Andhra Pradesh is at 25.8%. Karnataka and Maharashtra have 100%+ coverage ratios, which is a good sign - representative of economies that have a substantial services contribution. It also indicates sizeable migration towards Bengaluru and Mumbai as zones of high employment. The same could account for Telangana at 92% with Hyderabad. Gujarat remarkably also has a 100%+ coverage ratio. However, GER is 20.1 - lower than all-India GER - and can be improved to feed Gujarat's formal job creation engine.

ESI enrolment applies to 10+ employee entities across 90 industries. In 2017-18, ESI showed an increase of 17.97 lakh with 6.1% growth. There could be some double counting between ESI and EPFO subscribers.

NPS scheme is availed by citizens and government employees alike. Since 2004, new government employees are necessarily added on a defined contribution basis. PFRDA data (Table 3) shows number of new government employees has increased by 21.64 lakh from 2014-15 to 2018-19, 52.2% at a CAGR of 11% - indicating employment growth in the government sector as well. In 2018-19, 5.16 lakh new government employees registered.

Subscribers (lakhs)	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
Central Govt	15.12	16.58	17.89	19.22	19.85
State Govt	26.30	29.24	33.32	38.68	43.21
Total Govt	41.42	45.82	51.21	57.90	63.06
YoY Growth	8.02	4.40	5.39	6.69	5.16
YoY Growth Rate	24.0%	10.6%	11.8%	13.1%	8.9%

Table 3 – NPS subscriber data showing growth in government employment (data from PRFDA)

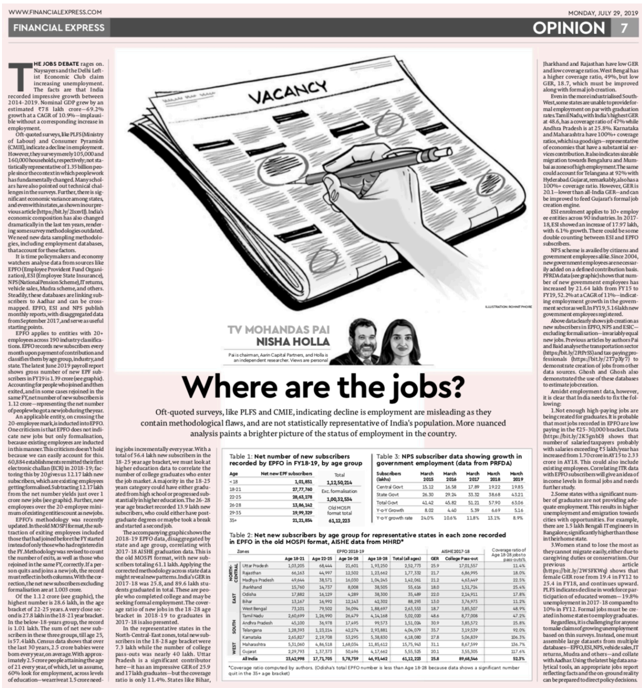
Above data clearly shows job creation as new subscribers in EPFO, NPS and ESIC - excluding formalization - invariably equal new jobs. Previous articles by authors Pai and Baid analyze the transportation sector (FE, Jobs on fast lane) and tax-paying professionals (FE, Claims of jobless growth during Modi regime bogus) to demonstrate creation of jobs from other data sources. Ghosh and Ghosh also demonstrated the use of these databases to estimate job creation.

Amidst employment data, however, it is clear that India needs to fix the following:

1. Not enough high-paying jobs are being created for graduates. It is probable that most jobs recorded in EPFO are low paying in the INR 25-30,000 bracket. Data shows number of salaried taxpayers probably with salaries exceeding 5 lakh/year has increased from 1.70 crore in AY 2014-15 to 2.33 crore in AY 2017-18. This could also include existing employees. Correlating ITR data with EPFO subscribers will give an idea of income levels in formal jobs and needs further study.
2. Some states with a significant number of graduates have very low coverage ratios. This results in higher unemployment and emigration towards cities with opportunities. For example, there are 1.5 lakh Bengali IT engineers in Bangalore; significantly higher than in their home state.
3. Women stand to lose the most as they cannot migrate easily, either due to caregiving duties or conservatism. Our previous article (FE, Holding Up Half The Sky) shows female GER rose from 19.4 in 2011-12 to 25.4 in 2017-18, and continues upward. PLFS indicates decline in workforce participation of educated women – 19.8% unemployment in 2017-18 compared to 10% in 2011-12. Formal jobs must be created in home states to employ graduates.

Regardless, it is challenging for anyone to make claims of growing unemployment based on thin surveys. Instead, one must assemble large data sets from multiple databases – EPFO, ESI, NPS, vehicle sales, IT returns, Mudra and others – and collate with Aadhar. Using the latest big data analytical tools, an appropriate jobs report reflecting facts and the on-ground reality can be prepared to direct policy decisions.

Link: Where are the jobs?



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FINANCIAL EXPRESS OPINION 7

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NISHA HOLLA

Pai is chairman, Aarin Capital Partners, and Holla is an independent researcher. Views are personal

Where are the jobs?

Oft-quoted surveys, like PLFS and CMIE, indicating decline is employment are misleading as they contain methodological flaws, and are not statistically representative of India's population. More nuanced analysis paints a brighter picture of the status of employment in the country.

Table 1: Net number of new subscribers recorded by EPFO in FY18-19, by age group

Age	Net new EPF subscribers	Total
<18	1,01,851	1,12,50,214
18-21	27,77,760	Exc. formalisation
22-25	28,63,278	1,00,32,534
26-28	13,86,142	Old MOSPI format total
29-35	19,99,329	61,12,223
35+	21,21,854	

Table 3: NPS subscriber data showing growth in government employment (data from PRFDA)

Subscribers (lakhs)	March 2015	March 2016	March 2017	March 2018	March 2019
Central Govt	15.12	16.58	17.89	19.22	19.85
State Govt	26.30	29.24	33.32	38.68	43.21
Total Govt	41.42	45.82	51.21	57.90	63.06
Y-o-Y Growth	8.02	4.40	5.39	6.69	5.16
Y-o-Y growth rate	24.0%	10.6%	11.8%	13.1%	8.9%

Table 2: Net new subscribers by age group for representative states in each zone recorded in EPFO in the old MOSPI format, AISHE data from MHRD*

Using Payroll Reporting

TV Mohandas Pai and Yash Baid

There are no comprehensive reports detailing job creation in India. Numbers for Formal sector employment have been arrived at for the first time in the ‘Towards a Payroll Reporting in India’ report by Prof. Pulak Ghosh of Indian Institute of Management, Bangalore and Dr. Soumya Kanti Ghosh, Group Chief Economic Adviser of SBI. The predecessors to the Ghosh Report were NSSO reports that, through their estimates, did not adequately represent the employment situation in the country. Thus emerges the need to develop a better mechanism to determine and report the job situation in the country.

A good place to start is analysing the supply of human capital in the jobs market. Taking into consideration the data from the Census of years 1991, 2001, and 2011, the Ghosh Report reveals that 2.5 crore babies are born every year. Consequently, 2.5 crore people attain the age of 21 annually today and will do so for the next 20 years as well.

Estimation of Number of Babies born every year	Unit	Net Yearly Babies Added
Census Year 1991	Lakh	253
Census Year 2001	Lakh	248
Census Year 2011	Lakh	252

Labour participation Rate among these 2.5 crore people is estimated at about 60%, i.e. 1.5 crore people enter the labour force every year. Further, the AISHE (All India Survey on Higher Education) report for 2016-17 highlights that the total number of graduates that pass-out in the country each year is around 88 lakhs. Within this demographic, the drop-out rate (not wanting a job) can be approximated at around 25%, helping us determine the incremental number of qualified people added to the labour force annually, ~66 Lakhs. Non-graduates as a proportion of the labour force would then come in at 84 lakhs.

Dynamics of Indian Labour Force	Unit	2017
Eligible Labour Force added per year as per above estimates	Lakh	250
Voluntary Non Participants in Labour Market (40%)	Lakh	-100
Net eligible Participants in Labour Force per annum	**Lakh**	**150**
Graduates per year (Gross incremental qualified manpower)	Lakh	88
Drop Out Rate (25%)	Lakh	-22
Qualified Manpower added to Labour Force per annum		**66,00,000**
Non-graduate/Non-qualified Labour (net of 150L - 66 L) per annum		**84,00,000**

Jobs, by definition, are split into the Formal and Informal sectors in India. Formal sector jobs are characterized by Social Security coverage. Social Security in India is provided by three organisations: EPFO, ESIC, and NPS (NPS is specific to government employees). The best sources of data for Formal job creation are the EPFO and ESIC, which cover a gamut of 190 and 90 industries, for those employing over 20 and 10 employees, respectively. The data for the last 6 months has been released by EPFO and ESIC and has been analysed thoroughly in the Ghosh report. As of March 2018, their findings revealed that 55 lakh incremental jobs have been registered with the EPFO, 9 Lakhs with the ESIC, and 7 Lakh with the NPS. Therefore, a total of 71 Lakh jobs have been created in the Formal sector according to incremental Social Security coverage in 2017-18. This data has been well construed and will only see nominal changes with better data coverage as 2018 progresses. It is, however, safe to assume that the formal sector generates close to 70 Lakh jobs a year as this data is based on monthly contributions and payroll.

Scheme		FY2018	Jobs created per annum
EPFO		55,00,000	
NPS		7,00,000	
ESIC		9,00,000	
Total new jobs created in the organized sector			**71,00,000**

We must also look at members of the population outside the scope of Social Security. Job creation among professionals like Chartered Accountants, Lawyers, and Doctors is key in generating employment, and needs to be an integral part of our calculations. According to ICAI (Institute of Chartered Accountants of India) data, there were 16,970 new Chartered Accountants added to the job force in 2017 with around 5,624 new practices setting up shop. The total jobs created by this segment of the population is a factor of additional human resources employed by the professional for setting up a new practice.

This applies to Doctors and Lawyers as well, with both adding approximately 80,000 to the labour force in 2017. Summing up ancillary staff members (clerks, paralegals, nurses, etc.) required to set up practices by these professions, we have surmised that over 6 lakh jobs were contributed through just these three professions in the Informal sector, with employment figures for other similar professions and consultancies not considered.

Chartered Accountants	FY 2016	FY 2017	Jobs created per annum
No. of new ICAI members 2016-2017		16,970	
No. of practicing firms in India (HQ & Branch)	79,993	85,617	
Addition of new practicing firms for the year 2016-2017		5,624	
Staff jobs created per year		1,12,480	
			1,18,104
Medical Professionals		**FY 2017**	**Jobs created per annum**
Total Doctors		25,282	
Total Dental Surgeons		53,473	
Total AYUSH doctors		2,200	
Total medical professionals in 2016-17		80,955	
Addition of new Practices for the year 2016-17 (@60%)		48,573	
Staff jobs created per year		2,42,865	
			2,91,438
Lawyers		**FY 2017**	**Jobs created per annum**
New lawyers (UG)		67,973	
New lawyers (PG)		11,387	
New lawyers		79,360	
Under Graduates that Practice (assuming 60% participation)		40,784	
Post Graduates that Practice (assuming 80% participation)		9,110	
Total new Practices per year		49,893	
Staff jobs created per year		1,49,680	
			1,99,574
Employment created by Professionals in 2016-17 (excludes Consultants, Cost Accountants etc.)			**6,09,116**

Further, the total stock of employment created through these three professions is around 1.08 crore, assuming 20 jobs per CA practice, 5 jobs per Medical practice, and 3 jobs per Law practice as per the below table.

Chartered Accountants	As at FY 2017	Jobs Stock
No. of practicing firms in India (HQ & Branch)	85,617	
Staff jobs created (@20 per practice)	17,12,340	
		17,97,957
Medical Professionals	**As at FY 2017**	**Jobs Stock**
Total Doctors	10,41,395	
Total Dental Surgeons	2,51,207	
Total AYUSH doctors	7,73,668	
Total medical professionals @60% participation	12,39,762	
Staff jobs created (@5 per Doctor & Dental Surgeon practice)	38,77,806	
Staff jobs created (@2 per AYUSH Doctor practice)	9,28,402	
		60,45,970
Lawyers	**FY 2017**	**Jobs Stock**
Total new Practice per annum	49,893	
Total Practices (assumption - 15x yearly increment)	7,48,401	
Staff jobs created (@3 per practice)	22,45,203	
		29,93,604
Total Stock of Employment created by Professionals (excludes Consultants, Cost Accountants etc.)		**1,08,37,531**

The skill development initiatives of the Government under the Pradhan Mantri Kaushal Vikas Yojana and National Skill Development Corporation provide the data as outlined below. They have successfully generated 5 lakh jobs in the previous year but may have been considered in other categories in the Formal or Informal Sector accounting.

PMKVY and NSDC		FY2017	Jobs created per annum
Total people trained as part of PMKVY and NSDC		10,18,572	
Placement percentage (49%)		4,99,100	
Jobs Creation due to PMKVY			**4,99,100**

The transport industry generates a large chunk of informal employment, made up of individuals or small firms owning vehicles. Data available from Society of Indian Automobile Manufactures (SIAM) is segregated by the types of vehicles, providing us sales and exports numbers across the commercial vehicles, three wheelers, and passenger vehicles categories. The capacity for employment for each of these vehicles can be assumed at around 2 per commercial vehicle, 1.5 per three-wheeler, and about 0.25 (1 in every 4 cars) for every passenger vehicle. Following this premise, it can be surmised that the transport sector contributes close to 20 lakh jobs per year, a figure oft overlooked by employment surveys and reports. These jobs would be in the Informal sector as these vehicles are typically owned individually and not by firms. This is buttressed by the fact that the EPFO and ESI data do not reveal these jobs in any large measure.

Vehicle Sales by Category		FY2018	Jobs created per annum
Commercial Vehicles Sold (net of exports)		7,59,586	
Replacement Rate (25%)		-1,89,897	
		5,69,690	
Jobs generated (Employment Capacity averaged at 2 per vehicle)			11,39,379
Three Wheelers Sold (net of exports)		2,54,696	
Replacement Rate (10%)		-25,470	
		2,29,226	
Jobs generated (Employment Capacity averaged at 1.5 per vehicle)			3,43,840
Passenger Vehicles Sold (net of exports)		25,40,678	
Replacement Rate (20%)		-5,08,136	
		20,32,542	
Jobs generated (Employment Capacity averaged at 0.25 per vehicle)			5,08,136
Jobs generated in the Transport industry, 2017-18			**19,91,354**

Commercial vehicles in India - trucks, LMV (goods), LMV (passenger), buses, and taxis – typically generate 2 jobs per vehicle. The cumulative stock of these in 2016-17 was about 2.25 crores. Therefore, the stock of jobs within the transport industry was extrapolated to be around 3.6 crores in India today.

Transport Industry Total Stock of Employment 2016-2017							
Zone	**State/UT**	**Trucks**	**LMV (Goods)**	**Buses**	**Taxis**	**LMV (Passenger)**	**Total Transport**
North	Punjab	4,84,291	1,46,423	58,252	3,127	6,27,946	**13,20,039**
	Uttar Pradesh	2,77,627	3,42,160	64,892	1,12,276	2,99,851	**10,96,806**
	Haryana	3,86,117	1,99,226	56,549	68,583	1,87,519	**8,97,994**
	Jammu and Kashmir	50,530	82,804	31,565	41,483	21,781	**2,28,163**
	Himachal Pradesh	77,872	69,234	22,853	34,706	3,953	**2,08,618**
	Uttaranchal	73,929	44,018	5,570	48,187	25,579	**1,97,283**
	Daman and Diu	4,778	1,990	NA	74	1,305	**8,147**
	Andaman and Nicobar Islands	NA	NA	1,106	489	4,931	**6,526**
East	Delhi	6,53,502	NA	97,065	1,32,967	6,73,342	**15,56,876**
	Meghalaya	15,426	12,654	5,668	24,172	21,939	**79,859**
	Jharkhand	69,124	1,62,122	75,636	16,837	1,53,332	**4,77,051**
	West Bengal	4,81,880	NA	35,369	1,28,308	70,010	**7,15,567**
	Orissa	1,69,324	1,65,858	26,150	1,15,139	1,39,732	**6,16,203**
	Bihar	1,06,933	55,744	32,940	97,703	2,76,042	**5,69,362**
	Assam	1,47,355	1,19,175	24,993	59,174	1,09,021	**4,59,718**
	Nagaland	1,41,663	23,978	6,131	9,324	19,832	**2,00,928**
	Tripura	9,095	11,525	3,051	12,542	26,340	**62,553**
	Mizoram	5,877	25,568	1,306	11,363	5,130	**49,244**
	Manipur	18,374	2,619	3,825	10,480	5,547	**40,845**
	Sikkim	4,018	1,591	417	14,028	NA	**20,054**
	Arunachal Pradesh	9,573	NA	NA	NA	NA	**9,573**
West	Maharashtra	4,45,370	9,92,856	1,42,989	3,43,659	7,10,060	**26,34,934**
	Gujarat	4,01,534	6,77,951	89,353	1,23,532	5,51,434	**18,43,804**
	Rajasthan	5,69,364	1,08,742	1,07,959	1,41,146	1,94,516	**11,21,727**
	Chandigarh	1,926	9,414	2,920	868	7,686	**22,814**
	Dadra and Nagar Haveli	2,984	4,019	423	2	496	**7,924**
South	Tamil Nadu	5,71,439	4,27,329	1,86,182	3,99,669	4,04,377	**19,88,996**
	Karnataka	3,07,840	4,08,005	92,602	2,94,684	4,51,980	**15,55,111**
	Telangana	6,15,420	NA	51,742	1,24,830	3,44,993	**11,36,985**
	Kerala	4,05,699	3,26,030	30,195	77,448	3,56,495	**11,95,867**
	Andhra Pradesh	1,62,694	2,11,168	44,482	82,190	4,97,610	**9,98,144**
	Goa (c)	44,219	18,416	11,733	19,350	4,433	**98,151**
	Pondicherry	1,143	11,325	2,722	5,124	6,952	**27,266**
	Lakshadweep	NA	1,082	NA	250	750	**2,082**
Central	Madhya Pradesh	2,09,275	2,66,274	47,884	19,975	1,27,487	**6,70,895**
	Chhattisgarh	1,29,047	95,428	63,829	23,601	40,733	**3,52,638**
GRAND TOTAL		**70,55,242**	**50,24,728**	**14,28,353**	**25,97,290**	**63,73,134**	**2,24,78,747**

Source:

Triangulated co-relation between transport departments of individual states combined with ministry of transport and infrastructure, extrapolated by Excellence4u

Transport Industry Total Stock of Jobs (2016-17)

	Trucks	LMV (Goods)	Buses	Taxis	LMV (Passengers)	Total Transport
Assuming jobs created per vehicle	2	2	2	2	2	
Jobs per vehicle	1,41,10,484	1,00,49,456	28,56,706	51,94,580	1,27,46,268	4,49,57,494
Assuming idle vehicles at 20%	-28,22,097	-20,09,891	-5,71,341	-10,38,916	-25,49,254	-89,91,499
Total Jobs stock in the Transportation Industry (2016-17)	1,12,88,387	80,39,565	22,85,365	41,55,664	1,01,97,014	**3,59,65,995**

The contribution to informal jobs creation is a factor of many other sources beyond the scope of this analysis. However, for the sake of brevity and reasoning, we have estimated that employment not covered by Social Security from professional and transport sectors alone contribute about 29 lakhs per year. Cumulatively, from the Formal and these Informal sectors, India generates over 1 crore jobs each year. This is an understatement as several informal sectors and MSMEs are not considered in this extrapolation. A complete picture of the employment scenario can only be achieved through the use of big data analytics over improved information reporting standards. In this article we restrict ourselves to only a few organized chunks of professionals and to the transport sector to determine an objectively conservative flow of employment for the year.

Sector			New jobs per year
Total new jobs created in the Formal sector (EPFO, NPS, ESIC)			71,00,000
	CA, Lawyers, & Medical Professionals	6,09,116	
	Other Professionals	3,00,000	
	Transport Sector	19,91,354	
Total new jobs created in the Informal sector			29,00,470
Total jobs created per annum			**1,00,00,470**

Further, the total active labour force in India is estimated in various studies to be around 50 crore (estimated based on NSSO 2012). As per the World Bank, agriculture contributes to the creation of around 43% of these jobs, thus bringing the workforce in Industry and Services to around 28.5 crore. Of this, we can quite conservatively appropriate that 9.5 crore are in formal employment as per the below table, placing India as the third largest Formal employment generator in the world after China and the US.

Scheme		Total Stock
EPFO (non zero)		6,00,00,000
Government Parastatal		2,50,00,000
ESIC		1,00,00,000
Total new jobs created in the organized sector		**9,50,00,000**

If we take jobs generated in the transport sector and through professionals, the number adds up to about 4.7 crore. This means that the other uncovered sectors in the Informal sector employ the balance of 14.3 crore, requiring periodic adjustments for unemployment through surveys.

Sector			Total jobs stock
Total stock of jobs in the Formal sector (EPFO, GPF, ESIC)			9,50,00,000
	Professionals	1,08,37,531	
	Transport Sector	3,59,65,995	
Total stock of jobs in the Informal sector			4,68,03,526
Total stock of jobs			**14,18,03,526**

This analysis elucidates the fact that India does not, in fact, have a job creation problem, but a wage problem. Low wages (of about INR 15-20K per month), especially in the informal economy, do not allow the Country's citizens to live a comfortable and productive life. Efforts need to be directed towards greater job formalisation, including increased social security coverage and better data gathering so that appropriate policies can be made.

It is important to note that India does not face a problem of not possessing the data to drive at its employment disposition. The right data is lying with the government, the authors of the Ghosh report have demonstrated that a planned approach of using 'Payroll Reporting' can be used to unclutter this data and provide accurate and invaluable insights.

Most importantly, this incontrovertible data proves that claims of jobless growth are completely unfounded and totally wrong. The Indian economy has grown significantly between 1991 to 2018 at the rate of 8.7% a year from USD 275 Bn to USD 2.6 Tn. Such growth cannot be jobless growth. Further, India's current GDP growth rate of 7.5% per annum would most certainly contribute towards a job growth rate of at the very minimum, 2.5-3% per year. As our Prime Minister said, we need better jobs data so that the focus is on good policy directed at creating more formal jobs rather than empty rhetoric about jobless growth.

Link: Using Payroll Reporting

PLANNED APPROACH TO EMPLOYMENT DATA

MECHANISMS

Using Payroll Reporting

TV Mohandas Pai
Yash Baid

Cumulatively, from the formal and these informal sectors, India generates over 1 crore jobs each year. This is an understatement as several informal sectors and MSMEs are not considered in this extrapolation. A complete picture of the employment scenario can only be achieved through the use of big data analytics over improved information reporting standards.

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A good place to start is analysing the supply of human capital in the jobs market. Taking into consideration the data from the Census of years 1991, 2001, and 2011, the Ghosh Report reveals that 2.5 crore babies are born every year. Consequently, 2.5 crore people attain the age of 21 annually today and will do so for the next 20 years as well.

Labour participation rate among these 2.5 crore people is estimated at about 60 per cent, i.e. 1.5 crore people enter the labour force every year. Further, the AISHE (All India Survey on Higher Education) report for 2016-17 highlights that the total number of graduates that pass-out in the country each year is around 88 lakhs. Within this demographic, the drop-out rate (not wanting a job) can be approximated at around 25 per cent, helping us determine the incremental

Table - 1

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10 YOJANA September 2018

Is the unemployment crisis for real?

TV Mohandas Pai and Yash Baid

The furor around the unemployment issue in India is ill-founded. Most of the analysis is based on incomplete representations of the Indian labor market. The recent surveys that profess spiraling unemployment are either unverifiable or heavily skewed by sampling biases. This narrative raises questions on the political motivations behind these surveys that may intend to demotivate the perception of India's growth trajectory, nationally and globally.

The CMIE survey claimed the total working population in India has declined by 1 crore in the last year. These preliminary estimates seem opportunistically quoted by the think-tank two months ahead of schedule. They have considered a minuscule sample of 140,000 respondents for a nation of 1.3+ billion citizens. With regards to the leaked excerpts of the NSSO survey, the public has been unduly kept in the dark about the methodology used to compute the claimed 6.1% unemployment rate.

Estimating a macro profile of employment for the whole country based upon a survey of even 2M participants is not statistically valid without a study of the various components of job creation. Such surveys have biased weights which have in recent times been contradicted by more concrete research. These surveys give higher weight to states with large populations but where less formal jobs are being created. There is a higher supply of formal jobs in Maharashtra and in South India than in states like UP and Bihar.

Another trend which was noticed was that jobs were being created in big cities. Employment intensity leans towards urban India, leading to intense migration to cities. However, cities hold a lower weight in the aforementioned surveys. A company called Betterplace Safety Solutions, which has one of the deepest databases of the formal sector workforce in the country, had recently released these revelatory migration trends. Until such biases are removed using actual data, we must reserve judgment.

We would request the government to come out with the norms and the methodology so it can be open to fair public debate. As citizens, we have to be critical of these immature practices of putting out headline-grabbing crumbs of incomplete information at opportune times.

India has been creating formal jobs in large numbers. There are social security databases which reveal formal employment as highlighted in the Ghosh report that urges India to follow the non-farm payroll system. Further, deliberations based on other proxy databases like vehicle sales in the country, the annual reports of the IT department, and Mudra loan disbursals help ascertain jobs in large job-creating markets like transport, professionals, and small-scale entrepreneurship respectively. This provides us with a more robust methodology of ascertaining employment than any survey used today.

We have estimated that India requires around 1.5 crore jobs a year. This is because India has got about 2.5 crore people attaining the age of 21 every year. We estimate that 40% of this population may not want formal jobs, as they choose agriculture or become homemakers after marriage. The social security databases point to around 70L jobs created annually (in companies with over 20 employees), the transport sector creates around 30-35L more jobs, and the professional sector creates around 6-10L jobs. That's 1.1 crore jobs being generated annually from these three sources alone. The remaining balance of 30-40L jobs is contributed by people starting their own ventures. India has not improved on its ease of doing business rankings for nothing, and this sector is expected to generate more employment with support from initiatives like Make in India in the future.

Today, if you talk to employers like shopkeepers, small, and large firms, they will tell you that they are not finding enough employees. This means that there are not enough skilled people in the market. Manish Sabharwal of Teamlease has been producing a yearly labor report documenting a healthy demand for jobs. However, these jobs provide insufficient compensation for the applicants. India has a wage problem and not a job problem. This problem can only be solved by creating higher quality jobs to meet aspirations.

If one looks at more accurate sources of data, there is no surge in unemployment. In the last 5 years, GDP has gone up by 76L crores. In the previous 5 years, it went up by 56L crores. Jobs have been created across governments - there is nothing to politicize.

Link: The methodology used in the surveys is questionable. What India has is a wage problem

Jobs on fast lane: Auto sector growth proof of sound jobs growth

TV Mohandas Pai and Yash Baid

The ongoing debate around jobs in the economy has been extremely skewed with unsubstantiated statements being heralded in the media diminishing the true state of employment growth in the economy. In a recent development, a think tank which purports to work on data has laid claim to the fact that the total working population in India has in fact declined by 10 million the last year. These numbers seem opportunistically quoted by CMIE two months ahead of schedule on preliminary estimates from a minuscule sample of 140,000 respondents from an already skimpy full sample size of 550,000 individuals that was to be initially released in February 2019. Obviously, the link with the forthcoming elections seems to a major reason for a premature release!

To gain a clear perspective on the employment delta, we need to look at data to understand the sources from where jobs are being created and assess the changes in employment's biggest contributors. The transportation sector is one of the largest job drivers in India. We have undertaken a study to assess the job creation by this sector on an annual basis over the past couple of years. We have considered data on the domestic sales of Commercial Vehicles (Medium & Heavy and Light Commercial Vehicles), Passenger Vehicles (Passenger Cars, Utility Vehicle, and Vans), Three-wheelers, and Tractors to estimate jobs being created in the economy. The data collected is from Society of Indian Automobile Manufacturers (SIAM) and the Tractor and Mechanization Association (TMA), the apex bodies for the automobile & farm mechanization (for tractor sales) industries. These bodies consistently collect and disseminate data regularly on production, sales, and export trends collected from all the various automobile manufacturers in India.

Every vehicle that is purchased in India creates jobs. For example, Commercial Vehicles typically create 2 jobs, an autorickshaw creates on an average 1.5 jobs as it is typically used in multiple shifts by different drivers. A taxi creates 1 job and further, many people have drivers to run their car, hence we can assume 1 job being created for every 4 Passenger Vehicles sold. Tractors also create a minimum of 1 job per vehicle sold. We further discount from the total domestic sales, reasonable replacement rates of 20% in the passenger vehicle segment, 25% in the commercial vehicle segment, 10% for three-wheelers (due to longevity of use of about 10-15 years), and about 20% for tractors. This is done in order to consider merely the new jobs created from the sales of these vehicles and not upgradation of their vehicles by existing workers. It is probable that there is a lag between sale and actual use, but that gets normalised over time. Analysts can make their own estimates of replacement to calculate new jobs.

It is to be noted that in calculating the jobs from this sector, we are not considering any ancillary jobs that are created, namely from repairs, servicing and the sale of spare parts, jobs from the direct or second-hand distribution and sales of the vehicles themselves and the scrapping of these vehicles, and lastly the jobs created for the sale of insurance, financing etc. These ancillary jobs would be quite significant in size by themselves. However, for this study, we only look at the direct job creation and yet, the following numbers are clearly substantial.

The chart below provides data on the jobs created. In our study, we have taken the total annual sale of vehicles from the April 1, 2014 when the NDA govt came into power, up until December 31, 2018.

Annual Automobile Domestic Sales, India					
Category	**FY 2014-15**	**FY 2015-16**	**FY 2016-17**	**FY 2017-18**	**9 months ending 31-12-2018**
Passenger Vehicles	26,01,236	27,89,208	30,47,582	32,87,965	25,33,929
Commercial Vehicles	6,14,948	6,85,704	7,14,082	8,56,453	7,12,806
Three Wheelers	5,32,626	5,38,208	5,11,879	6,35,698	5,25,333
Two Wheelers	1,59,75,561	1,64,55,851	1,75,89,738	2,01,92,672	1,67,50,270
Tractors	5,51,463	4,93,764	5,82,844	7,11,478	6,25,545
Total	**2,02,75,834**	**2,09,62,735**	**2,24,46,125**	**2,56,84,266**	**2,11,47,883**

Annual Jobs Created in the Transport Sector							
Category	**FY 2014-15**	**FY 2015-16**	**FY 2016-17**	**FY 2017-18**	**9 months ending 31-12-2018**	**Replacement Rate**	**Jobs per vehicle**
Passenger Vehicles	5,20,247	5,57,842	6,09,516	6,57,593	5,06,786	20%	0.25
Commercial Vehicles	9,22,422	10,28,556	10,71,123	12,84,680	10,69,209	25%	2
Three Wheelers	7,19,045	7,26,581	6,91,037	8,58,192	7,09,199	10%	1.5
Two Wheelers	-	-	-	-	-	-	-
Tractors	4,41,170	3,95,011	4,66,275	5,69,182	5,00,436	20%	1
Total	**26,02,885**	**27,07,990**	**28,37,951**	**33,69,647**	**27,85,630**		

Source: SIAM, TMA India, Analyst Projections & Estimates

We can clearly see that just the Transport sector alone has contributed almost 3.4M jobs in FY 2017-18, with further 2.8M jobs created in the 9 months ended 31st December 2018 as well. During the NDA term, over 14M jobs have been created in this sector. A sizable chunk of this workforce earns a healthy income of about INR 20-25K a month. There is a clear and growing demand for these jobs. About 70% of all goods movement happens by vehicles in India with the railway share further decreasing. It is evident that in an economy of the size of USD 2.6T which is growing at 7%+, huge number of jobs are being created. All we need to do is look at the job drivers and estimate the number of jobs.

Now there could be critics who look at our estimations, they are welcome to criticize and welcome to make their own estimations about the replacement and come out with their own numbers, but whatever be the final number - anybody who looks at this data can undeniably affirm that large scale jobs have been created in transportation and in the economy. Further, formal jobs counted through the EPFO, ESI, NPS, and in the professional sector are also large. The theory of jobless growth propounded by analysts, who have not seen this data, is indeed bogus.

EMPLOYMENT NUMBERS

THE TRANSPORT SECTOR ALONE HAS CONTRIBUTED ALMOST 3.4 MILLION JOBS IN FY18, WITH A FURTHER 2.8 MILLION JOBS CREATED IN THE 9 MONTHS ENDED DECEMBER 31, 2018

Auto sector growth proof of sound jobs growth

MOHANDAS PAI & YASH BAID

Pai is chairman of Aarin Capital Partners and Baid is head of research at 3one4 Capital

THE ONGOING DEBATE around jobs in the economy has been extremely skewed with unsubstantiated statements being heralded in the media diminishing the true state of employment growth in the economy. In a recent development, a think tank that purports to work on data has laid claim to the fact that the total working population in India has, in fact, declined by 10 million in the last year. These numbers seem opportunistically quoted by CMIE two months ahead of schedule on preliminary estimates from a minuscule sample of 140,000 respondents from an already skimpy full sample size of 550,000 individuals that was to be initially released in February 2019. Obviously, the link with the forthcoming elections seems to be a major reason for a premature release!

To gain a clear perspective on the employment delta, we need to look at data to understand the sources from where jobs are being created and assess the changes in employment's biggest contributors. The transportation sector is one of the largest job drivers in India. We have undertaken a study to assess the job creation by this sector on an annual basis over the past few years. We have considered data on the domestic sales of commercial vehicles (medium and heavy and light commercial vehicles), passenger vehicles (passenger cars, utility vehicle, and vans), three-wheelers, and tractors to estimate jobs being created in the economy. The data collected is from Society of Indian Automobile Manufacturers (SIAM) and the Tractor and Mechanization Association (TMA), the apex bodies for the automobile and farm mechanisation (for tractor sales) industries. These bodies consistently collect and disseminate data regularly on production, sales, and export trends collected from all the various automobile manufacturers in India.

Every vehicle that is purchased in India creates jobs. For example, the manufacturing of a commercial vehicle typically creates two jobs, an autorickshaw creates, on an average, 1.5 jobs as it is typically used in multiple shifts by different drivers. A taxi creates one job and further, since many people have drivers to run their car, we can assume an additional job being created for every four passenger vehicles sold. Tractors also create a minimum of one job per vehicle sold. We further discount from the total domestic sales, reasonable replacement rates of 20% in the passenger vehicle segment, 25% in the commercial vehicle segment, 10% for three-wheelers (due to longevity of use of about 10-15 years), and about 20% for tractors. This is done in order to consider merely the new jobs created from the sales of these vehicles and not their upgradation existing workers. It is probable that there is a lag between the sale and actual use, but that gets normalised over time. Analysts can make their own estimates of replacement to calculate new jobs.

It is to be noted that in calculating the jobs from this sector, we are not considering any ancillary jobs that are created, namely from repairs, servicing, the sale of spare parts, the direct or second-hand distribution and sales of the vehicles themselves, the scrapping of these vehicles, and the sale of insurance, financing, etc. These ancillary jobs would be quite significant in size by themselves. However, for this study, we only look at the direct job creation and, yet, the following numbers are clearly substantial.

The attached graphic provides data on the jobs created. In our study, we have taken the total annual sale of vehicles from April 1, 2014 to December 31, 2018. We can clearly see that just the transport sector alone has contributed almost 3.4 million jobs in FY17-18, with a further 2.8 million jobs created in the 9 months ended December 31, 2018 as well. During the NDA term, over 14 million jobs have been created in this sector. A sizable chunk of this workforce earns a healthy income of about ₹20,000-25,000 a month. There is a clear and growing demand for these jobs. About 70% of all goods movement happens by vehicles in India with the railway share further decreasing. It is evident that, in an economy of the size of $2.6 trillion, which is growing at 7%+, huge number of jobs are being created. All we need to do is look at the job drivers and estimate the number of jobs.

Now, there could be critics and they are welcome to criticise and make their own estimations about the replacement rate and come out with their own numbers, but whatever be the final number, anybody who looks at this data can undeniably affirm that large-scale jobs have been created in transportation and in the economy. Further, formal jobs counted through the EPFO, ESI, NPS, and in the professional sector are also large. The theory of jobless growth propounded by analysts, who have not seen this data, is indeed bogus.

Annual automobile domestic sales					
Category	FY15	FY16	FY17	FY18	9 mths ending. Dec 31, 2018.
Passenger vehicles	26,01,236	27,89,208	30,47,582	32,87,965	25,33,929
Commercial vehicles	6,14,948	6,85,704	7,14,082	8,56,453	7,12,806
Three-wheelers	5,32,626	5,38,208	5,11,879	6,35,698	5,25,333
Two-wheelers	1,59,75,561	1,64,55,851	1,75,89,738	2,01,92,672	1,67,50,270
Tractors	5,51,463	4,93,764	5,82,844	7,11,478	6,25,545
Total	2,02,75,834	2,09,62,735	2,24,46,125	2,56,84,266	2,11,47,883

Annual jobs created in the transport sector							
Category	FY15	FY16	FY17	FY18	9 mths ending Dec 31, 2018	Replacement rate	Jobs for vehicles
PVs	5,20,247	5,57,842	6,09,516	6,57,593	5,06,786	20%	0.25
CVs	9,22,422	10,28,556	10,71,123	12,84,680	10,69,209	25%	2
3-wheelers	7,19,045	7,26,581	6,91,037	8,58,192	7,09,199	10%	1.5
2-wheelers	-	-	-	-	-	-	-.
Tractors	4,41,170	3,95,011	4,66,275	5,69,182	5,00,436	20%	1.
Total	26,02,885	27,07,990	28,37,951	33,69,647	27,85,630	-	-

Source: SIAM, TMA India, Analyst Projections & Estimates

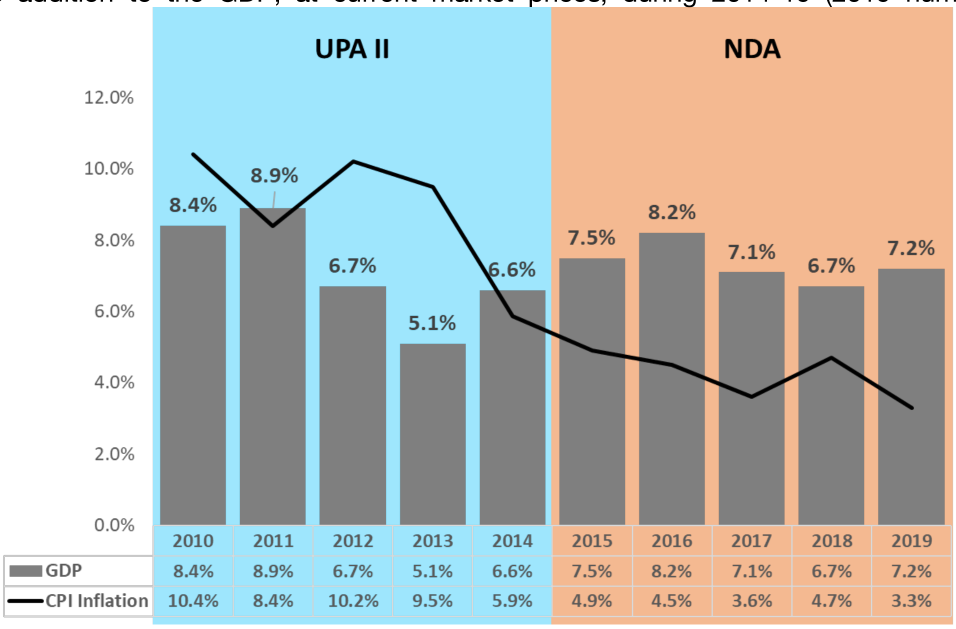
Link: Auto sector growth proof of sound jobs growth

Jobless growth in Modi years a bogus claim

IN THE PROFESSIONAL AND TRANSPORT SECTORS ALONE, A TOTAL OF 18 MILLION JOBS WERE CREATED BETWEEN 2014 AND 2019

TV Mohandas Pai and Yash Baid

It is an undisputed fact that India's economy has been fast growing over the past years, with India taking the title of 'fastest growing large economy' in 2018. What is more commendable, is that this growth lately has been achieved with low inflation. This has been the crucial achievement of the government over the past 4.75 years, having sustained India's pace of growth while reigning in the high levels of inflation that wreaked havoc during the term of the previous government.
Further, the addition to the GDP, at current market prices, during 2014-19 (2019 numbers are estimates) are over 28% higher than 2009-14. India's nominal GDP grew by INR 59 lakh crore in total during 2009-14 with high inflation. In contrast, nominal GDP grew by INR 76 lakh crore between 2014-19, but with low inflation - demonstrating much higher quality growth.



Source: RBI | GDP Growth numbers are pre-revision

An economy of the size of India, growing at such a pace cannot possibly suffer from jobless growth. In the UPA II era too, large scale jobs creation would have taken place. But, the UPA seems to have forgotten how to count these jobs and fell prey to the bogus theory of jobless growth.

To support our stance of healthy job growth, it is necessary for us to look at the key drivers of the nation's economy which create jobs. We had previously looked at the transportation sector in our Financial Express article published on January 15 (link: https://www.financialexpress.com/opinion/jobs-on-fast-lane-transport-sector-contributed-3-4-million-jobs-in-fy18/1443869/) , wherein we had estimated that this sector alone had added nearly 14M jobs from April 2014 to December 2018. Another large sector which creates jobs is the Professional sector, much of which is non corporate and outside the social security network.

Professionals who start their own practices also create significant number of jobs every year and need to be an integral part of our calculations. Job creation is high among professionals like Chartered

Accountants, Company Secretaries, Management Accountants, Lawyers, Fashion Designers, Doctors, Architects, Project Managers, Insurance Agents, Real Estate Brokers, Stock Market Brokers and intermediaries, and myriad other professional service providers. The total jobs created by this segment of the economy is also a function of the rich human capital graduating from our Universities and Professional entities.

There is consistent data available in the IT department's annual Income Tax Return Statistics Reports that provides a total of non-corporate professionals who are Tax Payers (TP). Non-corporate taxpayers declaring their income under the head - income from professions, implies that they are not paid salary for themselves but pay salary to people employed by them. Most non-corporate professionals will have employees under 20 in number, outside the purview of social security payments and can be counted separately. Based on the latest report for FY 2016-17(AY 17-18) there is a total stock of 2M such TP as of March 31, 2017. Taking the average growth of around 150,000 new TP per year, we can estimate the stock of non-corporate professional TP at 2.4M by March 2019. Of course, there will be more professionals working who may not be TPs but they will reflect as TPs in future years.

Total Tax Paying Professionals - Non Corporate				
Type of Business	**AY 2014-15**	**AY 2015-16**	**AY 2016-17**	**AY 2017-18**
Professionals [Chartered Accountants, Auditors,etc.]	80,231	87,821	92,625	1,02,895
Professionals [Fashion designers]	12,581	16,446	15,615	14,375
Professionals [Legal professionals]	1,79,282	2,20,790	2,38,223	2,55,600
Professionals [Medical professionals]	3,23,508	3,71,881	3,95,013	4,19,379
Professionals [Nursing Homes]	11,070	11,836	12,025	11,652
Professionals [Specialty hospitals]	4,135	4,538	4,667	4,601
Professionals [Others]	9,91,617	11,27,199	12,34,674	12,76,894
Total	**16,02,424**	**18,40,511**	**19,92,842**	**20,85,396**

Taking an extremely conservative estimate of each TP employing 5 individuals on an average, we can estimate that there is total current stock of minimum of 12M people employed in this sector alone. We further estimate that the three professions – chartered accountants, lawyers, medical professionals – together could be employing around 10M people because a majority of these professionals, who have been practising for 5+ years, would employ over 5 individuals. This is demonstrated in detail from our study which was published in the Yojana magazine in August 2018.

The increase in total non-corporate professional TP on a year on year basis helps us estimate the number of new practices being added every year. Using the same estimate of 5 jobs per practice, we can estimate from the table below that 8 lakh jobs are added from the Professional sector every year.

Y-o-Y Change in Non-Corporate Professionals				
Type of Business	**AY 2014-15**	**AY 2015-16**	**AY 2016-17**	**AY 2017-18**
Professionals [Chartered Accountants, Auditors,etc.]	7456	7,590	4,804	10270
Professionals [Fashion designers]	1628	3,865	-831	-1240
Professionals [Legal professionals]	18042	41,508	17,433	17377
Professionals [Medical professionals]	29,264	48,373	23,132	24,366
Professionals [Nursing Homes]	127	766	189	-373
Professionals [Specialty hospitals]	220	403	129	-66
Professionals [Others]	95,223	1,35,582	1,07,475	42,220
Total	**1,51,960**	**2,38,087**	**1,52,331**	**92,554**
5 Jobs per Non-Corporate Tax paying Professional	**7,59,800**	**11,90,435**	**7,61,655**	**4,62,770**

The table above shows the incremental increase in TP every year. It is possible that they were working earlier and they came into the tax bracket this year. However, this is an annual feature with a continuing pipeline and hence, normalises over time.

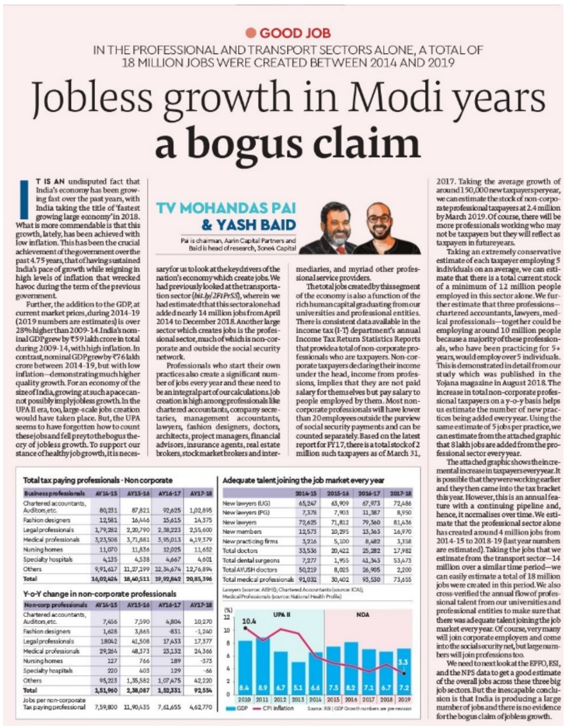
We estimate that the professional sector alone has created around 4M jobs from 2014-15 to 2018-19 (last year numbers are estimated). Taking the jobs that we estimate from the transport sector, i.e. - 14M over a similar time period – we can easily estimate a total of 18M jobs created in this period.

We also cross-verified the annual flow of Professional talent from our Universities and Professional entities to make sure that there was adequate talent joining the job market every year. Of course, very many will join corporate employers and come into the social security net, but large numbers will join the professions too. The table below gives the numbers:

Particulars	**2014-15**	**2015-16**	**2016-17**	**2017-18**
Lawyers *(source: AISHE)*				
New Lawyers (UG)	65,247	63,909	67,973	72,486
New Lawyers (PG)	7,378	7,903	11,387	8,950
New Lawyers	72,625	71,812	79,360	81,436
Chartered Accountants *(source: ICAI)*				
New Members	12,573	10,295	13,363	16,970
New Practicing Firms	3,216	5,100	8,482	3,358
Medical Professionals *(source: National Health Profile)*				
Total Doctors	33,536	20,422	25,282	17,982
Total Dental Surgeons	7,277	1,955	41,343	53,473
Total AYUSH Doctors	50,219	8,025	26,905	2,200
Total Medical Professionals	91,032	30,402	93,530	73,655

We need to next look at the EPFO, ESI, and the NPS data to get a good estimate of the overall jobs across these three big job data sectors. But the inescapable conclusion is that India is producing large number of jobs and there is no evidence for the bogus claim of jobless growth.

Link: Claims of jobless growth during Modi regime bogus; 18 million jobs in professional and transport sector alone in just 4 years



GOOD JOB

IN THE PROFESSIONAL AND TRANSPORT SECTORS ALONE, A TOTAL OF 18 MILLION JOBS WERE CREATED BETWEEN 2014 AND 2019

Jobless growth in Modi years a bogus claim

TV MOHANDAS PAI & YASH BAID

Pai is chairman, Aarin Capital Partners and Baid is head of research, 3one4 Capital

IT IS AN undisputed fact that India's economy has been growing fast over the past years, with India taking the title of 'fastest growing large economy' in 2018. What is more commendable is that this growth, lately, has been achieved with low inflation. This has been the crucial achievement of the government over the past 4.75 years, that of having sustained India's pace of growth while reigning in high levels of inflation that wrecked havoc during the term of the previous government.

Further, the addition to the GDP, at current market prices, during 2014-19 (2019 numbers are estimates) is over 28% higher than 2009-14. India's nominal GDP grew by ₹59 lakh crore in total during 2009-14, with high inflation. In contrast, nominal GDP grew by ₹76 lakh crore between 2014-19, but with low inflation—demonstrating much higher quality growth. For an economy of the size of India, growing at such a pace cannot possibly imply jobless growth. In the UPA II era, too, large-scale jobs creation would have taken place. But, the UPA seems to have forgotten how to count these jobs and fell prey to the bogus theory of jobless growth. To support our stance of healthy job growth, it is necessary for us to look at the key drivers of the nation's economy which create jobs. We had previously looked at the transportation sector (*bit.ly/2FtPrSS*), wherein we had estimated that this sector alone had added nearly 14 million jobs from April 2014 to December 2018. Another large sector which creates jobs is the professional sector, much of which is non-corporate and outside the social security network.

Professionals who start their own practices also create a significant number of jobs every year and these need to be an integral part of our calculations. Job creation is high among professionals like chartered accountants, company secretaries, management accountants, lawyers, fashion designers, doctors, architects, project managers, financial advisors, insurance agents, real estate brokers, stock market brokers and intermediaries, and myriad other professional service providers.

The total jobs created by this segment of the economy is also a function of the rich human capital graduating from our universities and professional entities. There is consistent data available in the income tax (I-T) department's annual Income Tax Return Statistics Reports that provide a total of non-corporate professionals who are taxpayers. Non-corporate taxpayers declaring their income under the head, income from professions, implies that they are not paid salary for themselves but pay salary to people employed by them. Most non-corporate professionals will have lower than 20 employees outside the purview of social security payments and can be counted separately. Based on the latest report for FY17, there is a total stock of 2 million such taxpayers as of March 31, 2017. Taking the average growth of around 150,000 new taxpayers per year, we can estimate the stock of non-corporate professional taxpayers at 2.4 million by March 2019. Of course, there will be more professionals working who may not be taxpayers but they will reflect as taxpayers in future years.

Taking an extremely conservative estimate of each taxpayer employing 5 individuals on an average, we can estimate that there is a total current stock of a minimum of 12 million people employed in this sector alone. We further estimate that three professions—chartered accountants, lawyers, medical professionals—together could be employing around 10 million people because a majority of these professionals, who have been practicing for 5+ years, would employ over 5 individuals. This is demonstrated in detail from our study which was published in the Yojana magazine in August 2018. The increase in total non-corporate professional taxpayers on a y-o-y basis helps us estimate the number of new practices being added every year. Using the same estimate of 5 jobs per practice, we can estimate from the attached graphic that 8 lakh jobs are added from the professional sector every year.

The attached graphic shows the incremental increase in taxpayers every year. It is possible that they were working earlier and they then came into the tax bracket this year. However, this is an annual feature with a continuing pipeline and, hence, it normalises over time. We estimate that the professional sector alone has created around 4 million jobs from 2014-15 to 2018-19 (last year numbers are estimated). Taking the jobs that we estimate from the transport sector—14 million over a similar time period—we can easily estimate a total of 18 million jobs were created in this period. We also cross-verified the annual flow of professional talent from our universities and professional entities to make sure that there was adequate talent joining the job market every year. Of course, very many will join corporate employers and come into the social security net, but large numbers will join professions too.

We need to next look at the EPFO, ESI, and the NPS data to get a good estimate of the overall jobs across these three big job sectors. But the inescapable conclusion is that India is producing a large number of jobs and there is no evidence for the bogus claim of jobless growth.

Total tax paying professionals - Non corporate

Business professionals	AY14-15	AY15-16	AY16-17	AY17-18
Chartered accountants, Auditors, etc.	80,231	87,821	92,625	1,02,895
Fashion designers	12,581	16,446	15,615	14,375
Legal professionals	1,79,282	2,20,790	2,38,223	2,55,600
Medical professionals	3,23,508	3,71,881	3,95,013	4,19,379
Nursing homes	11,070	11,836	12,025	11,652
Specialty hospitals	4,135	4,538	4,667	4,601
Others	9,91,617	11,27,199	12,34,674	12,76,894
Total	**16,02,424**	**18,40,511**	**19,92,842**	**20,85,396**

Y-o-Y change in non-corporate professionals

Non-corp professionals	AY14-15	AY15-16	AY16-17	AY17-18
Chartered accountants, Auditors, etc.	7,456	7,590	4,804	10,270
Fashion designers	1,628	3,865	-831	-1,240
Legal professionals	18042	41,508	17,433	17,377
Medical professionals	29,264	48,373	23,132	24,366
Nursing homes	127	766	189	-373
Specialty hospitals	220	403	129	-66
Others	95,223	1,35,582	1,07,475	42,220
Total	**1,51,960**	**2,38,087**	**1,52,331**	**92,554**
Jobs per non-corporate Tax paying professional	7,59,800	11,90,435	7,61,655	4,62,770

Adequate talent joining the job market every year

	2014-15	2015-16	2016-17	2017-18
New lawyers (UG)	65,247	63,909	67,973	72,486
New lawyers (PG)	7,378	7,903	11,387	8,950
New lawyers	72,625	71,812	79,360	81,436
New members	12,573	10,295	13,363	16,970
New practicing firms	3,216	5,100	8,482	3,358
Total doctors	33,536	20,422	25,282	17,982
Total dental surgeons	7,277	1,955	41,343	53,473
Total AYUSH doctors	50,219	8,025	26,905	2,200
Total medical professionals	91,032	30,402	93,530	73,655

Lawyers (source: AISHE); Chartered Accountants (source: ICAI); Medical Professionals (source: National Health Profile)

BUDGET

Budget 2020: A reformist budget which could have been more forward looking

TV Mohandas Pai and Yash Baid

With its GDP having grown steadfastly at an average of 7.4% over FY2014-2019, India's Economy was facing a growth hurdle owing to three primary challenges. First, a lack of consumer demand due to inadequate liquidity, second, lack of adequate investments, and third, a rather subdued mood due to burdensome compliances and low economic growth. To set a positive tone for Prime Minister Modi's second term, this was an important budget and The Finance Minister has tried to tackle each of these issues and move the needle.

The reduction in tax rates for personal income tax, despite being optional, will go a long way towards getting money back into people's hands by forgoing direct taxes of ₹40,000Cr. This, along with a budgeted outlay of ₹20,000Cr through the removal of the Dividend Distribution Tax, will bring about ₹60,000Cr of relief to the masses. A valiant step to boost investments came from increasing the fiscal deficit by 0.5% for FY20 & FY21. Loosening the fiscal deficit upon understanding the gravity of the economic condition is a prudent step. By increasing the deficit, the FM chose to opt for the special provisions under the FRBM Act. This was done to maintain tax buoyancy post the bumper Corporate Tax reforms from last year which will take more time to visibly demonstrate revenue growth for companies and in turn, increase tax collection for the government.

Policies to increase investments was given much needed attention in this budget. Granting 100% exemption to Sovereign Wealth Funds in infrastructure was a necessary move as getting these large pools of long-term capital to enter India was a process riddled with undue and complicated tax-hassles from the taxman, and not the tax rate itself. The listing of LIC has been long pending and is a positive move, it will necessitate much needed efficiency in the management of the publicly-run behemoth and generate liquidity for the Government. Further, increasing the FPI limit in corporate bonds to 15% will play a crucial role in deepening the bond market.

Increased allocations for agriculture and in the social sector are in tune with India's need and are a positive sign for the continued commitment of the Government to the growth of these sectors. It was good to see the Government starting conversations around the application of technologies like AI beyond startups, like in the national policy for statistics and the Ayushman Bharat scheme.

As far as technology and startups are concerned, the budget has been disappointing. While measures like setting up of the early-stage fund, investment clearance and advisory cell, fiber connectivity project BharatNet, the ₹8,000Cr outlay for Quantum technology, and providing tax rebates and extensions shows the emphasis given to this sector by the Government, the wholesome alleviation of more pressing concerns was amiss in the budget.

The startup sector had three major expectations from this government, one was the resolution of the ESOP issue to create wealth for the builders of high-growth companies. This has been brought to the attention of the FM but has only been paid hasty attention. ESOPs still get taxed twice, first at the point of exercise of the option and second, at the time of sale. Further, it's applicability to only eligible startups (incorporated post Apr 1, 2016 and recognized by the IMB) limits the strength of the proposed resolution. The second concern of the startup ecosystem was bringing tax parity on capital gains between Foreign and Indian investors. Capital gains for foreign investors and on public market exits are taxed at 10%, whereas high-risk tolerating early-stage Indian investors who largely find investments exits in the private market are taxed at an uncompetitive rate of 28%. Disincentivizing Indian investors who invest in India's innovation will lead to the country becoming a digital colony where its best young companies are largely owned by foreign capital. The third ask from the community was the reduction of TDS for startups. Most of these companies face losses in the first few years, with much needed capital getting blocked with the government through the TDS deductions. With entrepreneurship and startups being a high-growth and high-priority sector, the Finance Minister should have paid closer attention to the requisites of the startup ecosystem. However, none of these asks were met. Very disappointing.

Lastly, the startup capital of India, Bengaluru, has been choking in traffic congestion and this is disturbing the momentum of its growth and contribution to India's innovation. The suburban rail project promised in 2018 has finally been allocated a budget and it is our sincere hope that further delays do not cripple the city from reaching its tremendous potential.

All in all, this budget is a good budget keeping in mind the pressing economic needs of the country. However, the budget could have been bolder. Possible growth sops and more streamlined tax slabs coupled with the reduced corporate tax rates form the budget prior could have led to accelerated investments in the coming years and put India back on track for the projected 10% GDP growth.

TOP VIEW

MOHANDAS PAI
CHAIRMAN, AARIN CAPITAL PARTNERS

Reformist Budget which could have been more forward-looking

WITH ITS GDP having grown steadfastly at an average of 7.4% over FY2014-2019, India's economy was facing a growth hurdle owing to three primary challenges. First, a lack of consumer demand due to inadequate liquidity, second, lack of adequate investments, and third, a rather subdued mood due to burdensome compliances and low economic growth. To set a positive tone for Prime Minister Modi's second term, this was an important budget and the FM has tried to tackle each of these issues and move the needle.

The reduction in tax rates for personal income tax, despite being optional, will go a long way towards getting money back into people's hands by forgoing direct taxes of ₹40,000 cr. This, along with an outlay of ₹20,000 crore through the removal of the Dividend Distribution Tax, will bring about ₹60,000 crore of relief to the masses. A valiant step to boost investments came from increasing the fiscal deficit by 0.5% for FY20 and FY21. By increasing the fiscal deficit, the FM opted for special provisions under the FRBM Act.

Granting 100% exemption for sovereign wealth funds in infrastructure was a necessary move as getting these large pools of long-term money to enter India was riddled with complicated tax hassles, and not the tax rate itself. Further, increasing the FPI limit in corporate bonds to 15% will play a crucial role in deepening the bond market.

Increasing the FPI limit in corporate bonds to 15% will play a crucial role

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Link: Budget 2020: Budget 2020 could have been more forward-looking

India’s ESOP Taxation is the harshest amongst all Startup Hubs

T.V Mohandas Pai and Siddarth M Pai

Entrepreneurs are used to disappointment. They face it as an inevitable part of daily life. It rolls off them like water off a duck. But what hits them hard is being promised change that doesn’t materialise. Nothing exemplifies this more than what happened during the budget speech on February 1st.

Shri Nirmala Sitharaman articulated the role that Startups play in the economy, calling them “engines of growth for our economy”. For context, when our PM Shri Narendra Modi spoke about India’s aspiration in becoming a $ 5 trillion economy by 2025, he said that $ 1 trillion must be contributed by startups and new-age businesses, underscoring the import of them in our innovation economy. She highlighted the role ESOPs play in startups – “to attract and retain highly talented employees”. She even hit the nail on the head when she mentioned one of the core issues faced by employees exercising their ESOPs “*Currently, ESOPs are taxable as perquisites at the time of exercise… leads to cash-flow problem for the employees who do not sell the shares immediately*”. She even proposed measures that would help alleviate this issue, stating, “*to ease the burden of taxation on the employees by deferring the tax payment by five years or till they leave the company or when they sell their shares, whichever is earliest.”*

Which makes what followed in the Finance Bill 2020 all the more bewildering and disappointing. Instead of being rolled out to the over 27,000 DPIIT registered startups, have restricted this to the mere 500-700 startups recognised by the Inter-Ministerial Board (IMB). This led to an immediate uproar amongst all entrepreneurs as they felt that they had been deprived of something they have fought for and were promised over a decade.

DPIIT Proposes, CBDT Disposes

The Department of Promotion of Industry and Internal Trade (DPIIT) is the nodal body for the Startup India initiative, which is one of the personal initiatives of our PM, Shri Narendra Modi. Pm Modi personally gave a vision for Startup India as he felt that the future of India depends on her entrepreneurs and startups, and they will make “New India”. DPIIT articulates the policy for startups in the country, which has been widely adopted by all government bodies, departments and regulators bar one – the CBDT. DPIIT places the following primary conditions to be considered as a startup:

1. Less than 10 years of existence
2. Revenue less than Rs 100Cr
3. Innovative business or has the potential to create wealth or employment

CBDT placed two additional conditions for a startup to qualify for tax benefits, being:

1. Incorporation after April 1, 2016
2. Obtaining a certificate from the IMB for being "innovative"

The IMB process has been criticised since launch for being parsimonious with its certification, thereby depriving Indian startups of the tax benefits given the by government, which include:

1. A tax holiday of 3 years of out 10 years (Section 80-IAC)
2. Carrying forward losses if there's a change in control (Section 79)
3. Wholesale Angel Tax exemption (Section 56(2)(viib))
4. Investments into startups qualifying for a Capital Gains exemption, which has several conditions (Section 54GB)
5. Now, the ESOP change under section 156

Narrow Impact, Myopic Scope

Out of the 50,000+ startups operating in India, around 27,000 of them are registered with DPIIT. Out of these, a mere 500-700 startups have IMB certification. So conservatively, around 1% of the total startups operating in India can avail of the change in the ESOP taxation regime. This has severely curtailed the impact of this exemption to a fraction of the total startup ecosystem.

Even out of these 500 startups with IMB certification who can avail of the tax benefits, around 50% of them would have either shut down, been acquired or exceeded the revenue threshold of Rs 100 Crore now. Out of the remaining 250 companies, given the young age and revenue restriction, the average valuation may be taken assumed as Rs 200Cr. The standard ESOP pool is around 10% which needs to last for 5 years, bringing it to 2% exercise per annum. Thus. the total value of ESOPs that may be exercised (assuming 100% exercise) will be 200Cr x 2% which is Rs 4. Taking the tax payable at the highest slab rate of 30%, the total tax payable is Rs 1.2 Cr.

Total # of IMB certified Startups	500
%age of Cos whose certification would have lapsed	50%
Universe of eligible, live IMB startups	250
Average Valaution	200 Cr
Std ESOP Pool Size for 5 years	10%
Exercisable per annum	2%
Value of ESOPs exercised (per Co)	4 Cr
Tax Payable at Slab Rate of 30%	1.2 Cr
Total Tax Deferred for IMB startups	300 Cr

India's startup ecosystem raised $ 14.5 billion in 2019, with the valuation being over $ 150 billion, the impact of the ESOPs change is beyond negligible. Indian startups deserve better.

India's ESOP Regime

India’s ESOP taxation issue has been the payment of tax on notional gains at the point of exercise. India’s taxation regime on ESOPs is as follows:

1. The difference between the Fair Market Value and the Exercise Price of the options is taxed as Income from Salaries
2. The difference between the Sale Price and the Fair Market Value at the point of sale is taxed as Income from Capital Gains

These work for listed companies, where an employee can sell the shares upon exercise of the options, thus giving them liquidity to pay their taxes. Unlisted companies and startups, being private companies who lack a market and free transferability by law, cannot sell their options upon exercise.

The current structure does not solve the issue of double taxation. Finance Bill 2020 states that the tax payable upon the exercise of ESOPs will be determined at the point of exercise, but payable at the earlier of:

- Five years from exercise
- The employee departing the company
- Sale of the shares

So, after the point of exercise, if the Sale Price is less than the Fair Market Value at the point of exercise, the tax liability determined above will still be payable. That pain point hasn’t been eased. This is why entrepreneurs asked for the taxes to only be determined and paid at the point of sale, so such events out of the control of the employees don’t adversely impact them.

The issue of Fair Market Value, which was the bane of “Angel Tax”, is also at the core of the ESOP taxation issue. Rule 3(8)(ii), Income Tax Rules, 1962 state that the FMV for ESOPs has to be determined by a Merchant Banker. The Company’s Act (Section 42 and Section 62(1)(c), read with Rule 13 of Company’s (Share Capital and Debentures) Rules 2014) since that needs to happen at the Fair Market Value. RBI reporting under FEMA also require the securities issued to non-residents to be done at the Fair Market Value. Furthermore, due to section 56(2)(viib), this “fair market value” report cannot deviate from the price of the latest issue of shares at a premium since it would lead to two fair market values for the securities at the same time, causing taxation issues.

Thus, the same issue plaguing Angel Tax, which still needs to be fully resolved, lies at the heart of the ESOP taxation issue. The double taxation issue hasn’t been solved; the issue of FMV deviation hasn’t been solved. What has been proposed is only a deferral of the tax, for select companies, which still lags what the rest of the world offers.

India’s ESOP regime compared to the rest of the World

In a recent interview with CNBC TV 18, Shri Ajay Bhushan Pandey stated that one must compare India’s ESOP regime with the other startup ecosystems across the world.

India is the third-largest startup ecosystem in the world, behind only the US and China in terms of capital raised, the number of unicorns and the number of startups. Hence India can only compare herself to them when it comes to startup policies. Singapore has become the launchpad into India, with several Indian startups and India-focussed businesses setting up base there only to access the Indian market. Hence a comparison with Singapore is apt to gauge our Startup policies.

Singapore:
In Singapore, ESOPs are taxed as per the IRAS e-tax Guide titled "*Tax Treatment of Employee Stock Options And Other Forms of Employee Share Ownership Plans (Second Edition)"*
Under the Singapore regime, ESOPs are taxed as the difference between the Open Market Price at the point of exercise versus the Exercise Price. **However, for unlisted entities and startups, the Open Market Price is defined as the Net Asset Value, i.e., Book Value of the securities.**

USA:
In the USA, ESOPs are taxed as the difference between the FMV and the exercise price, with the FMV being governed by section 409A. The Board needs to obtain a "fair market value" report using a "reasonable valuation method" taking into consideration:

- The value of tangible and intangible assets,
- Control premiums or discounts for lack of marketability,
- Whether the valuation method is used for other purposes, and
- Other financial and non-financial items.

In addition to the reasonable valuation method, the valuation is considered presumptively reasonable if it meets one of the Safe Harbour criteria below:

- A qualified independent appraiser performs the valuation
- For startup companies, someone other than an independent appraiser who has the requisite knowledge and experience performs the valuation, and the valuation satisfies other criteria under Section 409A.

Thus, deviations between the latest capital raise & the fair market value of the ESOPs so exercised is permissible.

China:
Since 2016, China's Ministry of Finance has created a more benign regime for ESOP taxation in China **for unlisted companies allowing employees who have exercised ESOPs to defer taxation to the point of sale and will only be taxed once as 'Capital Gains", not twice – under Salary and Capital Gains.**
Hence, against the global best practises for ESOP taxation worldwide, being:

1. Defer taxation to the point of sale (China)
2. Allow for any method taking into consideration asset value, including book value, so long as it's performed by a registered valuer (USA)
3. Tax the difference between the Book Value and the Exercise Price (Singapore)

India's ESOP tax policy:

1. Limits the scope to a narrow section of the startup universe
2. Doesn't solve the issue of using the latest funding round to determine the FMV in spite of no single employee being able to command that price in the market due to startup financing agreements and liquidation waterfalls
3. Doesn't solve the issue of double taxation

Indian startups deserve better. This was not the Startup India that Shri Narendra Modi promised Indian entrepreneurs.

Safeguards against abuse
Startups and entrepreneurs can demat their securities to prevent abuse of the deferral of tax to the point of sale. Tracing the PAN of the employee and linking it to the TDS deduction under section 192B will ensure traceability. The reporting of ESOP exercise is part of the Company's Act reporting framework. So the risk of abuse is low.

Conclusions:
Allowing for greater equity participation is one of the most meaningful changes that can foster a sense of entrepreneurship not just amongst promoters and founders, but also amongst employees. Startups are driving the next wave of job creation, economic development and innovation the world over.

But Indian startups deserve more conducive and sympathetic tax policies to grow and compete in this complex world. Far too many entrepreneurs have left India to set up shop in other geographies while their business remains here. India cannot afford to become a land of subsidiaries.

The translation of intent from the PM and FM to policy has been lacking severely when it comes to taxation. Indian startups are still treated as step-children compared to listed companies, with the "superrich surcharge" that was rolled back for listed companies still applying to startups. Angel Tax too went through multiple iterations and is yet to reach a satisfactory conclusion.

Startup India is being undermined purely on the basis of its tax policies. New India cannot afford to sacrifice her future at the altar such perverse and adverse tax policies.

TV MOHANDAS PAI & SIDDARTH PAI

UNION BUDGET 2020

ESOPs fables

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FINANCIAL EXPRESS

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2019: FM Sitharaman delivered a transformative Budget

TV Mohandas Pai and Yash Baid

The mandate for the first budget under Modi 2.0 was given to Nirmala Sitharaman under stressed growth conditions. The emphasis of this budget was rightly on laying down a strong vision for next five years as opposed to announcing large outlays. This is a welcome move and addresses the need for strengthening the economy of the nation and improving the lives of citizens. The FM further lowered the fiscal deficit target for FY20 to 3.3% of GDP from 3.4%.

The focus of the Government since the last term has been to provide the bare necessities of life to every Indian citizen and it is well on its way of delivering on that promise. Substantial expenditure on social infrastructure is continued in this budget. The most far reaching impact amongst these reforms will come in the boost given to higher education. The proposed National Education Policy will help groom and retain India's top talent. There has not been enough quality research output from our universities. The creation of the National Research Foundation to foster research is thus, timely. Setting up the Higher Education Commission to bring in greater autonomy to institutes will create better academic outcomes.

Large-scale infrastructure development will be the next frontier of this Government, catalysing and supporting the growth from other sectors. Logistics in India accounts for

14.4% of GDP, this is twice as much as those of western economies. There is tremendous potential for bringing in efficiencies here. The Government announced its intention to invest ₹ 100 lakh crore in infrastructure over the next five years. Projects from the current budget to restructure the National Highway Programme, upgrading the Railway and Inland Waterway infrastructure, and making power accessible across states at consistent costs will lend more efficiency in the logistical network post the GST reforms that eased cross-state goods movement.

Streamlining the 44 existing labour laws and structuring them into four labour codes will standardise compliance processes for businesses. Easing the tedious bureaucracy around registration and returns filing will help bring down business costs and also invite foreign investment in labour-intensive industries. The formalisation of labour will help bring in wage parity and reduce labour disputes and harassment.

There were critical mandates taken up by the FM to propel some upcoming sectors. Investment-linked income tax deduction will help attract global companies to set up mega-manufacturing plants in sunrise and advanced technology areas like Semi-conductor fabrication (FAB), solar photo voltaic cells, lithium storage batteries, solar electric charging infrastructure, computer servers, laptops, etc. In a dedicated move to help India's growth complement the protection of the environment, the Government has given a big boost to the development of India as a manufacturing hub for Electric Mobility and its adoption within the country. Phase-II of the FAME scheme will make an outlay of ₹ 10,000 Cr to encourage faster adoption of Electric vehicles. From income tax deductions to the tune of ₹ 1.5 Lakh on EV loans to reduction of GST and custom duties – the sector as a whole has been given a very healthy push.

In the most important announcement coming in from the current budget, the FM announced the initiative to increase sovereign borrowings in external currencies. This will ease pressure on domestic savings and interest rates and bring in much needed liquidity to the market, providing good support to bolster consumption. To grow at a rate of 8-9%, the country needs more inflow of overseas capital. Initiatives to make the FDI program more lucrative for investors was much needed, especially in the sectors targeted – aviation, media, and insurance. The disinvestment target of ₹ 1.05 Lakh Cr will be achieved on the backs of the healthy growth in popularity of ETFs.

Corporate tax rate of 25% was widened to include companies with annual turnover up to ₹ 400 Cr, covering 99.3% of the companies. What the government does not account for, however, is that the remaining 0.7% of companies are the ones largely competing against international companies in markets where corporate tax rates have been lowered in the past couple of years. These are the companies that are grooming the best of India's formal sector talent and hence, must be supported in their growth. At the same time, the benefits to MSMEs in this budget are laudable and helps sustain the entrepreneurial zeal of Indians.

Easing credit access to businesses post the NBFC crisis last year while strengthening the banking infrastructure was the absolute need of the hour. The FM has taken good steps in this direction. To help financially sound NBFCs raise capital, the government allocated ₹ 1,00,000 Cr to make a partial credit guarantee of 6 months for PSBs to purchase high-rated pooled assets for first loss of up to 10%. Further, the requirement of Debenture Redemption Reserve for public issues of debt by NBFCs will also be removed. Building a deeper corporate bond market to increase access to low cost capital will help drive investment-led growth. PSU banks too have been given a strong capital boost of ₹ 70,000 Cr.

The NDA government continued its fight against the black economy, incentivising digital payments in business transactions by levying TDS of 2% on withdrawals over ₹ 1 Cr from a single bank account. The interchangeability between Aadhar and PAN cards for filing tax returns will also help. Back in 2014, Arun Jaitley had made a commitment to rein in tax evasion. Since then, the government has only increased the tax burden on honest taxpayers and tax terrorism has not seen any substantial reduction. People who have diligently been following the law and declaring their true income are penalised with a higher tax rate every year. In 2016, the FM increased surcharge by 3% on individuals with income over ₹ 1 Cr. In 2017 the surcharge became 10% for individuals with income between ₹ 50 Lakh and ₹ 1 Cr. This year again, individual with incomes over ₹2 & ₹5 Cr will be charged a higher rate of tax, with surcharges of 10% & 15% respectively. Must there be such a premium on honesty? No effective steps for reducing tax terrorism, perverse assessments, or tax disputes have been announced.

The FM has removed the Angel tax harassment from AIF Category I & II investors, which is a much-anticipated relief. However, to encourage investors to invest in high-risk, low-liquidity startups, capital gains must be brought down from 20% to 10%. If not incentivised, these investors will simply flock back to the less risky public markets. The startup ecosystem must be encouraged as a whole in order to grow and create better-paying, long-term jobs for the country and incentivise Indian investors. Today India is well on its way to becoming a Digital Colony as most of our largest digital startups are substantially owned by overseas investors, this must be remedied on priority by the government. The lack of clarity on the creation and disbursement of the ₹ 20,000 Cr Startup Seed Fund has been disappointing. ESOP taxation, which currently places undue burden upon employees by taxing them on exercise, based on the price paid by investors, has not seen any change either. Finally, the new budgetary provisions for the GIFT City will attract global companies to make long-term investments and make help make a mark as a global financial hub.

Considering the headwinds in the global economy and India's growth opportunity, this budget will hopefully be transformative through the reforms announced and play a crucial role in setting a stable platform for the next five years.

Link: Budget 2019: FM Sitharaman delivered a transformative Budget

● TOWARDS GROWTH

CONSIDERING THE HEADWINDS IN THE GLOBAL ECONOMY, THE REFORMS ANNOUNCED IN THIS BUDGET WILL PLAY A CRUCIAL ROLE IN SETTING A STABLE PLATFORM FOR THE NEXT FIVE YEARS

FM delivered a transformative Budget

TV MOHANDAS PAI & YASH BAID

Pai is Chairman, Aarin Capital & Baid is Head of research, 3one4 Capital

THE MANDATE FOR the first budget under Modi 2.0 was given to Nirmala Sitharaman under stressed growth conditions. The Budget's emphasis was rightly on laying down a strong vision for the next five years as opposed to announcing large outlays. This is a welcome move, addressing the need for strengthening the economy, and improving citizens' lives. The FM further lowered the fiscal deficit target for FY20 to 3.3% of GDP from 3.4%.

The focus of the government since the last term has been to provide the bare necessities to every Indian citizen and it is well on its way to success. Substantial expenditure on social infrastructure is continued in this budget. The most far reaching impact of these reforms will come in the boost given to higher education. The proposed National Education Policy will help groom and retain India's top talent. There has not been enough quality research output from our universities. The creation of the National Research Foundation to foster research is, thus, timely. Setting up the Higher Education Commission to bring in greater autonomy to institutes will create better academic outcomes.

Large-scale infrastructure development will be the next frontier for this government, catalysing and supporting the growth from other sectors. Logistics in India accounts for 14.4% of GDP—twice as much as those of western economies. There is tremendous potential for bringing in efficiencies here. The government announced its intention to invest ₹100 lakh crore in infrastructure over the next five years. Projects from the current budget to restructure the National Highway Programme, upgrading the Railway and Inland Waterway infrastructure, and making power accessible across states at consistent costs will lend more efficiency in the logistical network post the GST reforms that eased cross-state goods movement.

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In the most important announcement from the current Budget, the FM announced the initiative to increase sovereign borrowings in external currencies. This will ease pressure on domestic savings and interest rates and bring in much needed liquidity to the market, providing good support to bolster consumption. To grow at a rate of 8-9%, the country needs more inflow of overseas capital. Initiatives to make the FDI program more lucrative for investors were much needed, especially in the sectors targeted—aviation, media, and insurance. The disinvestment target of ₹1.05 lakh crore will be achieved on the back of the healthy growth in popularity of ETFs.

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Easing credit access to businesses post the NBFC crisis last year while strengthening the banking infrastructure was the absolute need of the hour. The FM has taken good steps in this direction. To help financially sound NBFCs raise capital, the government allocated ₹1,00,000 crore to make a partial credit guarantee of six months for PSBs to purchase high-rated pooled assets for first loss of up to 10%. Further, the requirement of Debenture Redemption Reserve for public issues of debt by NBFCs will also be removed. Building a deeper corporate bond market to increase access to low cost capital will help drive investment-led growth. PSU banks, too, have been given a strong capital boost of ₹70,000 crore.

The NDA government continued its fight against the black economy, incentivising digital payments in business transactions by levying TDS of 2% on withdrawals over ₹1 crore from a single bank account. The interchangeability between Aadhar and PAN cards for filing tax returns will also help. Back in 2014, Arun Jaitley had made a commitment to rein in tax evasion. Since then, the government has only increased the tax burden on honest taxpayers and tax terrorism has not seen any substantial reduction. People who have diligently been following the law and declaring their true income are penalised with a higher tax rate every year. In 2016, the FM increased surcharge by 3% on individuals with income over ₹1 crore. In 2017, the surcharge became 10% for individuals with income between ₹50 lakh and ₹1 crore. This year again, individual with incomes over ₹2 & ₹5 crore will be charged a higher rate of tax, with surcharges of 10% & 15% respectively. Must there be such a premium on honesty? No effective steps for reducing tax terrorism, perverse assessments, or tax disputes have been announced.

The FM removed the angel tax harassment from AIF Category I & II investors, which is a much-anticipated relief. However, to encourage investors to invest in high-risk, low-liquidity startups, capital gains must be brought down from 20% to 10%. If not incentivised, these investors will flock back to the less risky public markets. The startup ecosystem must be encouraged in order to grow and create better-paying long-term jobs for the country and incentivise Indian investors. Today, India is well on its way to becoming a digital colony as most of our largest digital startups are substantially owned by overseas investors; the government must remedy this on a priority basis. The lack of clarity on the creation and disbursement of the ₹20,000 crore Startup Seed Fund has been disappointing. ESOP taxation, which currently places undue burden upon employees by taxing them on exercise based on the price paid by investors, has not seen any change either. Finally, the new budgetary provisions for the GIFT City will attract global companies to make long-term investments and help India make a mark as a global financial hub.

Considering the headwinds in the global economy and India's growth opportunity, the reforms announced in this budget will hopefully be transformative and play a crucial role in setting a stable platform for the next five years.

Access to the basic necessities of living

- **Healthcare:** Health assurance to 346 mn under Ayushman Bharat
- **Electrification:** 100% village electrification in 988 days
- **Mobile:** 775 mn mobile users, 135 mn smartphones sold per annum
- **Education:** Drop off rate to be curbed
- **Roads:** 85% of habitations connected with PMGSY
- **Internet:** 500 mn first- time internet users by 2020
- **Housing:** Subsidised financing for 1.5 cr homes since 2014
- **Sanitation:** 99% household coverage under Swachh Bharat
- **Banking:** PMJDY gave 80% Indians a bank account by 2017
- **Water:** 88% of population has access to clean water close to home
- **Food Security:** All 36 states/UT now covered under NFSA vs 11 in 2014
- **Gas connections:** From 120 mn to 250 mn since 2014. 72 mn under Ujjwala

Source: Government bodies, World Bank, Global Carbon Project, UNESCO, UNDP, WaterAid

Budget 2019 valiant effort by Nirmala Sitharaman, sets up pace for NDA-II

TV Mohandas Pai and Yash Baid

In keeping with the Modi government's focus on upgrading the quality of life for the Aam Aadmi, the 2019 budget has continued its programs to ensure that all Indians have access to the bare necessities of life by 2022. There has been significant spending on improving social living conditions, with a focus on housing, water, power, health, gas stove, sanitation, etc. There will further be investments to the tune of ₹ 100 Lakh Crores to improve infrastructure over the next 5 years. These are crucial endeavours for the NDA government in its vision of Reform, Perform, and Transform India.

Higher education has been given particular focus during this budget, which is good to see. The proposed National Education Policy will help groom and retain India's top talent. The creation of the National Research Foundation to foster research in higher education is timely. The quality of higher education has not taken enough strides forward in the past years primarily due to a lack of enough quality research output. Setting up the Higher Education Commission to bring in greater autonomy to institutes will permit a better focus on better academic outcomes.

Amongst the widespread reforms undertaken by Nirmala Sitharaman in her first budget, the most prominent area of focus has been in the financial sector. In a sluggish growth environment with international overhang, PSU banks have been given a strong capital boost of ₹ 70,000 Cr. For the purchase of high-rated pooled assets of NBFCs upto ₹ 1,00,000 Cr, the Government will provide a one-time 6 months' partial credit guarantee to Public Sector Banks for first loss of up to 10%, easing the credit chokehold on small businesses post the NBFC crisis last year. Building a larger corporate bond market will increase access to low cost capital helping drive investment-led growth.

In a bold and impressive step – the Finance Minister will initiate a sovereign borrowing programme from external markets in external currencies, which will bring much needed liquidity in the market and buoy consumption. Easing norms for FDI in aviation, media, and insurance sectors and simplifying the KYC process for FPIs were much needed, propping up disinvestment opportunities and the inflow of external capital.

Digitisation continues to be a priority for the NDA government, with an effort being made to curb off-the-books cash payments in business transactions. However, there is a stark contrast in the way the government focusses on detracting dishonesty in tax payments while at the same time penalising honest taxpayers with incomes over 2 & 5 crores with surcharges of 10% & 15% respectively.

An important topic that needed to be given some more focus was the creation of quality jobs. Creating jobs and improving the money the nation's farmers make is certainly important. However, it is important to understand India's demographic trends, well outlined in the economic survey released a couple of days back. Good quality, long-term jobs will be developed in sectors showing healthy growth. The focus should be more on growing India's large companies and promoting new-age technology startups.

The Angel tax was a harassment, the finance minister has committed to remove this tax from AIF Category I & II investors. However, removing this harassment cannot be construed to be a benefit for startups. To promote investments and growth of startups, investors must be incentivised. Such high risk, low liquidity investors cannot be taxed the same way stock market investors, who leverage low risk and high liquidity conditions, are taxed. Bringing down capital gains for such investors from 20% to 10% will promote the growth of a healthy ecosystem for startups to grow and create better paying, long term jobs. This measure has been overlooked.

The government will overhaul the complications arising from the 44 labour laws by consolidating them into 4 broad labour codes. This will help in bringing down compliance costs by businesses and improving the formalisation of labour, helping bring wage parity.

All reforms considered, this budget has been a valiant effort by Nirmala Sitharaman, where she has addressed most of the issues that India faces today.

Link: Budget 2019 valiant effort by Nirmala Sitharaman, sets up pace for NDA-II

Setting the pace for NDA-II

All reforms considered, this Budget has been a valiant effort by Nirmala Sitharaman

TV MOHANDAS PAI, CHAIRMAN, AARIN CAPITAL PARTNERS

IN KEEPING WITH Modi government's focus on upgrading the quality of life for *Aam Aadmi*, the Budget has continued its programmes to ensure all have access to the bare necessities by 2022. There has been significant spending on improving social living conditions, with a focus on housing, water, power, health, gas stove, sanitation, etc. There will further be investments to the tune of ₹100 lakh crore to improve infra over the next five years. These are crucial endeavours for 'Reform, Perform, and Transform India' vision.

Higher education has received particular focus, which is good to see. The proposed National Education Policy will help groom and retain top talent. The creation of the National Research Foundation is timely. The quality of higher education has not taken enough strides in the past years, due to lack of quality research output. Higher Education Commission will provide greater autonomy to institutes, and will increase focus on better academic outcomes.

Amongst the widespread reforms, the most prominent are in the financial sector. In a sluggish growth environment with international overhang, Public Sector Banks (PSBs) have been given a capital boost of ₹70,000 crore. For the purchase of high-rated pooled assets of NBFCs up to ₹1,00,000 crore, the government will provide a one-time six months' partial credit guarantee to PSBs for first loss of up to 10%, easing the credit chokehold on small businesses post the NBFC crisis last year. Building a larger corporate bond market will increase access to low-cost capital, helping drive investment-led growth.

In a bold and impressive step, Sitharaman will initiate a sovereign borrowing programme from external markets in external currencies, which will bring much-needed liquidity, and buoy consumption. Easing norms for FDI in aviation, media, and insurance sectors, and simplifying the KYC process for FPIs were much needed, propping up disinvestment opportunities and inflow of external capital.

In a bold and impressive step, Sitharaman will initiate a sovereign borrowing programme from external markets in external currencies

Digitisation continues to be a priority, with an effort to curb off-the-books cash payments in business transactions. There is a stark contrast in the way the government focuses on detracting dishonesty in tax payments while also penalising honest taxpayers with incomes over ₹2 and ₹5 crore with surcharges of 10% and 15%, respectively.

An important topic that needed more focus was creation of quality jobs. While creating jobs and improving farmers' incomes is certainly important, it is equally important to understand India's demographic trends, well-outlined in the Economic Survey. Good quality long-term jobs will be developed in sectors showing healthy growth. The focus should be more on growing India's large companies and promoting new-age technology start-ups.

The angel tax was harassment; the FM has committed to remove this from AIF Category I & II investors. However, this cannot be a benefit. To promote investments and growth, investors must be incentivised. Such high-risk, low-liquidity investors cannot be taxed the same way as stock market investors, who leverage low-risk, high-liquidity conditions. Bringing down capital gains for such investors from 20% to 10% will promote the growth of a healthy ecosystem and create better paying long-term jobs. This has been overlooked.

There is overhaul of complications arising from the 44 labour laws by consolidating them into four labour codes. This will bring down compliance costs for businesses and improve the formalisation of labour, helping bring wage parity.

All reforms considered, this Budget has been a valiant effort by Sitharaman; she has addressed most issues India faces today.

Co-authored with Yash Baid, Head of Research, 3one4 Capital

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Modi Govt's last budget a dream budget for aam aadmi

TV Mohandas Pai and Yash Baid

This last budget of the current government has been a dream budget. The NDA came to power 5 years back with the promise of a clean government, good governance, job creation, and the provision of the basic necessities of life to all Indian citizens. Each of these promises has been substantially met.

Today, for the first time, all Indians can have a realistic hope of having a roof over their head, electricity and gas stoves in their homes, food on the table, water in the tap, access to toilets and roads, a bank account, a mobile connection, education for their children, and overall – a life of dignity. Many of the programs undertaken by the government over the past five years will lead to these hopes being fulfilled fully within the next two years.

Having focussed on reigning in double-digit inflation numbers to a low of 2.19% in December 2018, the government has not lost track of GDP growth. This has been achieved without overspending, which could have led to an untenable deficit. From being the 11th largest economy in the world in 2013-14, we are today the 6th largest in the world.

Despite many negative narratives run by vested interests, the government has performed phenomenally. GST has brought in efficiency and collections are picking up every month. Demonetisation has broken the back of the black economy and coupled with the digitization of the collections systems, indirect tax filers have grown by an unprecedented 80% and collections have gone up by almost 90%. India has also undergone a remarkable transformation in infrastructure development with substantial improvements in coverage and quality of roads, railways, ports, and airports.

The fiscal situation is very much under control as the deficit stands at 3.4% for 2018-19. It is to be noted, however, that excluding the planned disbursal for the PM Kisan Yojana (₹20,000 crore for 2018-19 and ₹75,000 crore for 2019-20), the fiscal deficit would meet the targeted 3.3% for this year and 3.1% for the following year. The quality of spending by the NDA has certainly gone up over the years, and the fears of the government having to dip into the RBI's books, which were spread due to vested interests, has been proven to be unfounded. The debt management has been good with borrowings for the year being within a healthy range.

This budget has been well structured to meet the aspirations of most sections of society. 12 crore small and marginal farmer families have been provided a direct annual income support of ₹6,000. 42 crore unorganized sector workers will benefit from a large new pension scheme providing a monthly pension of ₹3,000. The Ayushman Bharat scheme launched last year will further provide medical treatment to 50 crore people. The defense sector has been given a good leg up. The middle-class has been provided a tax rebate on income upto ₹5 Lakhs, the salaried class have got an increased standard deduction of ₹50,000. These measures have been very much in line with what were the expectations of the Indian people.

But while everybody has something to cheer for, startup entrepreneurs are yet get relief from the dreaded “angel tax” (section 56(2)(viib)), a tax on capital receipt from Indian investors if it’s above the fair market value of the shares. The DIPP has called several startups and investors for a roundtable on February 4th in Delhi and the CBDT actioned the recent DIPP circular and made its partial relief retrospective, the Finance Minister should have addressed this issue. This was a golden chance for the government to redress the largest thorn in the side of Start-Up India. Hopefully, relief is only deferred and will not be denied.

Crores of new middle-class people have come into the SIP program for the first time ever and are yet to see any great appreciation in their holdings. It was a premature move to introduce the capital gains tax and hence was widely expected to be removed, but the lack of its abolishment has created some disappointment.

The Finance Minister brought to the fore the advancements in the economy over the NDA term, and how it has laid the path for India to grow to a $5 Trillion economy in the next 5 years. The Vision Statement presents a well-rounded, inclusive, and progressive approach towards a “modern, technology driven, high growth, equitable, and transparent India”. This is quite objectively, a fantastic roadmap that unifies and works towards the aspirations of every individual and segment of India’s demography. Every political party should form a consensus with and work towards this common goal of the holistic growth of all segments of our nation.

Despite this being an interim budget for the government, it has all the foresight of a full-fledged budget. Some people have criticized it as an election budget, which it undoubtedly is, as the party is gearing up for elections in May. Overall, this has been a great budget for the aam aadmi – the farmers, the middle class, the vulnerable sections. The Finance Minister has done an impeccable job in articulating our progress towards laying a strong foundation and must be congratulated for setting the stage for the next phase of growth for New India.

Link: A Dream Budget

A dream budget!

This is a great budget for the *aam aadmi*—farmers, middle-class and the vulnerable sections

TV MOHANDAS PAI, CHAIRMAN, AARIN CAPITAL PARTNERS

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With contributions from **Yash Baid**, Head of Research, 3one4 Capital

Budget 2019 – Relief for Startups and Investors, but where is Startup India 2.0?

Siddarth M Pai

Entrepreneurs across India were eagerly looking forward to the launch of "Startup India 2.0" – a slew of measures to consolidate the gains made by Startup India 1.0 and to create the roadmap for the next 100,000 startups that India needs to foster by 2025. Rumours were abound about a host of previous asks – relaxation of ESOP taxation, lowering the capital gains rate on the sale of startup shares, lower TDS rates for payments to startups, amongst others.

The budget offered relief from the spectre of 'Angel Tax' by the creation of a 'Supervising Administrator" to look into all pending "angel tax" cases and redress their grievances. Furthermore, the permission of this authority will be required for the opening of an inquiry by an assessing officer into a startup who raised funds at a premium. Thus, the long-standing issues of the startup community about bringing relief to those who were excluded from the February 2019 DPIIT circular have come to fruition.

Along with this, the government has finally clarified its stance on section 68 as well, which deals with "unexplained cash credits", especially with regard to share premium. The fear that section 68 could become the new angel tax was compounded by the over 80% tax rate associated with section 68. A few startups and investors have already received notices for the same (a note on the same has been published here - https://inc42.com/resources/how-can-we-stop-section-68-from-becoming-the-new-angel-tax/). With the announcement of e-verification of investors and the exemption from scrutiny of investments from such verified investors, section 68 can be put to rest as well.

The creation of a TV channel was a welcome surprise to many entrepreneurs, who are calling the programme "India's Shark Tank". Hosted on DD, this shall no doubt promulgate entrepreneurship and startups across the nation. Section 79 with regard to the carry-forward of losses was enhanced to include cases regarding IBC, the transmission of shares, mergers of foreign companies with domestic subsidiaries, etc. But this only extends to those who have an IMB certification, which is still a fraction of the over 40,000 startups in the country.

From an investor's perspective, Category II AIFs have been extended the same exemption from section 56(2)(viib) as afforded to Category I AIFs. This further demonstrates the commitment of the government to tackle "angel tax". The carry forward of losses for investors into Category I and II AIFs, a long-standing ask of Indian investors, has finally been afforded. This has corrected a distortion in the tax code with only incomes being passed on without the associated losses/expenses.

But the other measures that were awaited, such as a change in the taxation of ESOPs – which is currently taxed as the difference between the price at which the investor invests (FMV) and the strike price upon exercise and again on the difference between the sale price and the

FMV. This has hampered the effectiveness of ESOPs as a tool for retention and compensation. The tax rates on the sale of shares of a startup still command a tax rate that's twice their listed counterparts, in spite of being more illiquid and riskier. Measures such as lower TDS on payments to startups, removal of MAT, more incentives for rupee capital to participate in the startup growth story didn't figure in the speech.

The most alarming omission was that of the Rs 20,000Cr Seed Startup Fund that was part of the 2019 election manifesto.

Overall, startups can breathe a sigh of relief that they will no longer be plagued by the angel tax and investors are glad that they can finally carry forward the losses from their investments into funds. For everything else, *picture abhi baaki hai.*

Link: Budget 2019 Relief for startups

Budget 2019: Start-Up hopes deferred, but hopefully not denied

Siddarth M Pai

The 2019 interim budget is carefully crafted as an election budget which spoke about what the government has done over the past 5 years, how the populace has benefited and an articulation of what the government plans to do in the future. It had a little bit of something for everyone: a 60,000 Crore allocation for MGNREGA, a direct income support schemes to farmers of Rs 6,000 a year, interest subvention to MSMEs, animal husbandry and fisheries, increase in social security cover via NPS, gratuity, bonus, a mega pension plan for the unorganised sector and a full rebate of any income tax paid for annual income up to Rs 5 lakh.

But the silence on the issues plaguing startups has been deafening.

From startups being mentioned 14 times in the 2015-16 budget in points of policy, they were mentioned a mere 5 times in this budget. Of course, the Indian startup ecosystem has grown immensely and is among the top 3 in the world today. There is no doubt that startups deserved more attention.

The entire investor and entrepreneurs are anguished that the dreaded "Angel Tax" (section 56(2)(viib)) has not been expunged. Other long-standing demands of companies including amendment of section 54GB – the tax exemption for investing into startups, rationalising ESOP taxation, removing the tax arbitrage between sale of startup shares and listed shares were also not redressed.

One of the reasons for this is that this was an interim budget and a vote on account. However, given the measures announced, the honorable Finance Minister could have offered an articulation of what the government intends to do in the future.

All eyes are now on the DIPP roundtable scheduled on February 4th, 2019 in Delhi on the "angel tax" issue. The CBDT has also actioned the January 16th, 2019 DIPP circular on January 31st, 2019.

Any startup who has received a notice should speak to their chartered accountant and submit the circular during their appeals.

Hopefully, relief is only deferred but not denied.

Link: Budget 2019: Hopes Deferred, but hopefully not denied

Budget 2019 - A chance to Launch Startup India 2.0

Siddarth M Pai

From being in charge of India's sovereign security to her financial security, Mrs Nirmala Sitharaman has her task cut out for her.

From being part of the "Fragile Five" in 2014, India has emerged as the bulwark of global financial growth, overtaking even China in terms of GDP growth. With the ongoing trade wars between US and China, slowdown in Europe and fears of another recession, India has stunned the world by articulating a vision of becoming a 5 trillion-dollar economy by 2025.

One of the engines of this growth is going to be startups and increasing trends of digitisation. India has seen the rise of over 40,000 startups who have created more than 130 billion dollars of value from January 2014 to September 2018. With around 32 unicorns (billion-dollar startups), India is the third largest startup ecosystem in the world in terms of value and numbers, behind China and the US. These startups help create new markets, export revenue and jobs – crucial elements of growth for any economy.

The Startup India mission has bought this to the forefront and created the regulatory infrastructure to achieve this: quicker incorporation, lessening the corporate compliances for startups, allowing them greater flexibility in raising capital, alleviating the burden of angel tax from new startups, etc. This helped create over 40,000 startups on record currently. But for India to reach 100,000 startups as stated by the President during the opening of the parliamentary session, we need something larger – we need Startup India 2.0.

From a budget perspective, Startup India 2.0 needs to solve for the following challenges:

- Rationalised rates to increase competitiveness
- Tax incentives to attract investment
- Lowering the compliance burden
- Enhancing credit and capital to Indian startups

Rationalised rates to increase competitiveness

Tax ESOPs on sale, not on exercise

Employee Stock Options or ESOPs are a tool of compensation and retention the world over and allow for employee participation in a startup's rise. But due to India's tax policies, ESOPs have become a SOP story for most employees.

Currently, ESOPs in India are taxed as follows:

- On exercise of options: Difference between Fair Market Value (FMV) and Exercise Price
- On sale: Difference between Sale Price and FMV from above

This impairs the effectiveness of ESOPs as employees are taxed on the difference between the latest round price and the strike price when they exercise the options, resulting in an immediate economic outflow. Furthermore, since the shares are illiquid, there is no ready market for the same and in case the company is sold for a loss, they lose the entire amount. Thus, to ensure that ESOPs are more employee friendly, they should be taxed only on sale and not on exercise Heightened reporting norms by the company can ensure that there is no leakage in the chain and that the tax due on sale can be traced.

Lower the TDS rate on payments to Startups and MSMEs to 2% from 10%
Any payment to a startup or MSME in the services sector is subject to tax being deducted at source of up to 10% of the gross amount under section 194J. However, most of these startups and MSMEs are not profitable yet, and they need to wait for months after filing their returns to get their refunds. This also exacerbates the working capital crisis they're facing as they find it hard to avail of credit at competitive rates or even get credit at all.
The budget should thus lower the TDS rate under section 194J to 2% for payments to DPIIT startups and registered MSMEs to ease their working capital issues.

Lower the tax rate on LLPs to 25%
The Financial Year 2016 budget saw the government lower the corporate tax rate for companies to 25%, with a promise to lower it for all businesses to the same in the future. This has greatly helped private limited companies <u>but several startups and MSMEs are LLPs, who are subject to the 30% rate + cess. LLPs can also register as startups as per DPIIT and Startup India</u>
Thus, the tax rate on LLPs should be lowered to 25% to bring them on par with companies.
Tax incentives to attract investment

Lower the Long-Term Capital Gains rate on the shares of startups to 10%
Shares of startups are more illiquid, risky and less frequently traded as compared to listed shares, yet they suffer from <u>a tax rate that's twice the rate</u> of their listed, liquid counterparts. In order to incentivise participation in the startup growth story, the government should lower the tax rate on the sale of shares of startups or companies who were startups as recognised by DPIIT to 10%

Tax Incentives for investing in Startups
Currently, Section 54GB currently gives an exemption of up to Rs 50 lakhs on capital gains <u>from residential property</u> invested into the shares of an eligible startup, but has various restrictions such as:

- Condition on ownership of 50% of the eligible startup for 50 lakhs, making it unviable for investments into third-party startups
- Restrictions on the application of funds to avoid computers and software, which effectively excludes investments into technology startups
- Restriction on type of eligible capital gains (sale of residential house property), on type of shares eligible (only common equity), restriction on exits, etc

All these have curtailed the effectiveness of this section.
To make this section more attractive, the following changes are proposed:

- Allow for any capital gains invested to be eligible, <u>not only gains from residential property</u>
- Remove the 50% ownership threshold and allow for investment into any securities convertible to equity shares
- Allow the funds invested to be used for the purchase of computers and software
- Allow investments into any startup recognised by DPIIT
- Total exemption amount per annum should be Rs 1 Crore

This will further incentivise entrepreneurs and Indian investors to become equity participants in the Indian Startup story

Tax Incentives for investing in AIFs
Currently, Section 54EE of the Income Tax Act allows for a deduction of up to Rs 50L for investments into units of "specified funds", but there hasn't been a notification on what characterises "specified funds" and this section is due to lapse this year.
To action this, the budget should specify that all SEBI registered Category I and II AIFs constitute "specified funds" and the tenure and amount should be raised till April 1,2023 and upto Rs 1 Cr per annum.

Lowering the compliance burden

Bring relief from Angel tax once and for all
The February 19th, 2019 DPIIT notification numbered G.S.R. 127(E), which was actioned by CBDT on March 5th, 2019 via notification No. S.O. 1131(E) helped alleviate the "angel tax" issues faced by Indian startups. However, the notification does not apply to those who had received orders prior to the notification and also states that the exemption lapses in the case the startup has or will invest or conduct any of the activities below for a period of 7 years after investment, inter alia:

- Make capital contributions to other entities,
- Make investments in shares and securities,
- Give loans and advances in the ordinary course of business cause

These activities are required in the ordinary course of a startup's life as they scale up, create subsidiaries, give advances to vendors, contribute to an ESOP Trust, etc
To alleviate this, the budget should propose the following:

- **One-time amnesty to all DPIIT startups who were excluded from the scope of the notification**
- Allow startups to make capital contribution to other entities or investments into shares and securities so long as the downstream investment does not make further investments into the other items mentioned in the negative list
- Allow for loans and advances to be made in the ordinary course of business and any such loans/advances outstanding after 180 days would need to be reported

Lowering the compliance time for startups and MSMEs to 1hr a month:
Many startups and MSMEs are struggling to comply with the number of filings to be made to government authorities under GST, Income Tax, company's act, etc.
The government should take concrete steps to lower the compliance time for startups, MSMEs and other business to only 1 hour a month.

Enhancing credit and capital to Indian startups

Creation of the Rs 20,000 Cr Startup Seed Fund:
The Rs 20,0000 Cr Startup Seed Fund as stated in the election manifesto should be sanctioned and created this year to help galvanise equity investments into Indian startups and also allow for working capital loans

Creation of Collateral Free Credit scheme:
The creation of the collateral free credit scheme as stated in the 2019 Manifesto will greatly help accelerate entrepreneurial ambitions which were hampered by the lack of access to credit. For DPIIT registered startups, this amount should be extended to Rs 5Cr

Scheme for working capital loans against GST Invoices:
The Goods and Services tax (GST) has created a single nationwide market for the free flow of goods and services across the country. With this, startups and MSMEs have begun selling to large enterprises and government. However, startups and MSMEs suffer from severe lack of credit and working capital loans.
Thus, the creation of a scheme where MSMEs and startups can avail of loans against the discounting of GST invoices on the creditworthiness of the counterparty will help bolster the GST regime and allow for credit to startups and MSMEs.

The first budget of a new government has the weight of the dreams of the entire nation on its shoulders and balancing the aspirations of various groups. In PM Modi, Indian startups have found their most vocal supporter and are eagerly awaiting what the government has in store for them to enable the next leg of their journey.

Link: Budget 2019, a chance to launch Startup 2.0

2018 Budget: Good proposals for agriculture, rural areas

TV Mohandas Pai and Yash Baid

The 2018 budget is the last full budget by the NDA government. In their first couple of years, this government opened up the economy on the backs of some important policies and going after black money. It has done very well in these areas as it has had an average GDP growth of 7.5% for the first three years, with this year's growth expected to be around 6.75%. One expected legitimately for this to be a political budget, with expectations running high.

The expectations were not disproved, with the focus on the core constituencies of farmers, people below the poverty line, and the lower-middle-class income groups maintained steadfastly. The budget has good proposals for agriculture and the rural areas, health, senior citizens, and education infrastructure. The budget proposes to focus on 'ease of living' of its constituents after successfully focusing on the 'ease of doing business' in the past years.

Further, the rural sector will get all-weather roads to connect to markets, which is going to have a tremendous impact in the long term. Rural housing has been given a massive boost, and the free LPG programme has been rightly extended to 8 crore families, as against 5 crores. This will definitely have a positive impact on the poor in these areas, who have faced much distress over the past two years.

The increased expenditure in infrastructure to INR 5.97L crore is rightfully been directed towards will help make India more competitive by reducing supply chain jobs. It shall also contribute to the growth in jobs and exports.

The Government has committed to contribute 12% of the wages of the new employees in the EPF for all the sectors for next three years, while also reducing women employees' compulsory contribution to 8%, these moves are positioned to be an integral boost to formal-sector job creation. After many debates over job-growth, we are finally seeing a policy-focus on employment. However, sufficient incentives have not been given to the labour-intensive services sector, which has the higher potential to create jobs as compared to the capital-intensive manufacturing sector.

Investors awaited with bated breath for doing away with the draconian angel tax but that did not materialize. The Finance Minister acknowledged that the Government has taken various measures to develop the and promote the Startup and Venture Capital ecosystem and decided that they require a special regime to ensure their sustained growth. Several low-hanging fruits which would have solved the chronic malaise enervating startups and investors were not addressed by the Finance Minister in his speech.

On the taxation front, the budget has been a disappointment. The Finance Minister reasoned that demonetization resulted in increased buoyancy in personal income tax collection from 1.1 in 2016 to 1.95 & 2.11 in the two succeeding years, leading to INR 90,000 Cr in excess revenues. He claimed that business persons do not pay higher taxes in comparison to the salaried class, which is an excuse for the underwhelming policy change that fails to reward the honest tax-paying salaried class and expands the dishonesty premium for the business class.

The government has not kept the promises of reducing the corporate tax rate from 30% to 25%. The established turnover limit to avail this diminished rate has gone up from INR 50 Cr to INR 250 Cr, increasing the proportion of companies covered by this rate to 99% of all taxpaying corporates. This statistic fails to convey the ground reality that the majority of taxes collected come from the balance 1%, whose rates remain at 35% with an additional burden coming this year in the form of a surcharge. Furthermore, the cess has been increased from 3% to 4%.

Another disappointing measure comes in the form of taxation of LTCG at the rate of 10% for gains exceeding INR 1 lakh. This will have an adverse impact on the net returns earned, hurting investor sentiments. This has come as a shock, as people were expecting that this issue would not be raked up in the final full budget by the NDA government. Coming as it does when large sums are entering mutual funds, this could have been prioritised a couple of year later.

Overall the budget expectedly focuses on the vulnerable strata of society - the electing majority, and barring a few token perks, does not provide any promising news for the corporate sector. However, I would rate this budget 9 out of 10, primarily due to the fact that vulnerable sections of our society are getting full attention and the outlay on infrastructure, education, and health has gone up.

2018 Budget: Skills development

TV Mohandas Pai and Yash Baid

The budget has sent strong signals of intent to continue to support the focus on empowering its citizens, particularly in education.

In education, the intent to move from blackboards to digital boards is a clear signal of encouragement to the edtech startups. Jaitley said: "The government is set to increase digital intensity in education. Technology will be the biggest driver in improving quality of education”. It is very heartening to note that the budget has taken previous recommendations in this domain seriously.

The ‘‘Prime Minister’s Research Fellows (PMRF)’’ scheme that incentivizes the very best tech talent in the country to become relevant stakeholders to grow more such talent is clearly a step in the right direction. Diksha portal’s focus on training 13 lakh teachers through the Right to Education Act further boosts this agenda. The continued focus to adding infrastructure in the education sector especially for tribal children in their own environment will go a long way in improving the depth of impact of training and skill development. ‘‘Revitalising Infrastructure and Systems in Education (RISE) by 2022’’, with INR 1L crore of dispensable funds has tremendous potential to interlock these varied initiatives into one cascading wave of progress that will drive the evolution of education in the country.

Over the past six decades, the priority in Indian education has clearly been to promote 100% enrollment and rise against the inertia of drop-out rates. This move has made good progress, and now the budget is rightly focusing on taking the paradigm of education forward. With renewed support towards research and teacher training, and investment in improving access to education, the fundamental install base of educational infrastructure will most definitely become more robust. This should allow education and skill development companies to pursue important value propositions such as technical skill development and training, multi-lingual content development, intelligent content distribution, and improving the job readiness of graduates.

This renewed focus on a new paradigm in education must prioritise quality and make sure every enrolled student finds the most direct path to achieving their learning goals and job outcomes. Government spending must continue to go into expanding the install base of fundamental layers of innovation - providing free wifi at all educational institutions, a tablet to every student in every school and college in the country and enable every teacher and school administrator with a smart device. On top of this install base, public spending must invest in and establish incentives for the development of high-quality educational content that is multi-lingual and multi-format and create a free open national knowledge base. The role of teachers must go from information dissemination to content curation and the amplification of problem-solving. The budget makes good first steps towards this technologically-driven future.

However, skill development initiatives and stimulus could have been linked to the market using additional incentives and clearer directives. The taxation policies that were announced might adversely impact job creation. In a market where taxation stresses new job creation, the imperative on helping candidates develop the skills that matter in the market should not be ignored. More is needed to prioritise skill development and bring candidates closer to market readiness.

In summary, the budget has taken several steps to improve the quality of education and skill training, but more needs to be done to help job seekers and new graduates in a more tangible manner.

Budget 2018 is unclear on startup concerns, disappoints on angel tax

TV Mohandas Pai and Yash Baid

The last full budget of the NDA government will have significant reverberations in the startup ecosystem.

Investors awaited with bated breath for doing away with the draconian angel tax but that did not materialize. The Finance Minister acknowledged that the Government has taken various measures to develop the and promote the Startup and Venture Capital ecosystem and decided that they require a special regime to ensure their sustained growth.

The LTCG exemption provided to listed equity suffered a major blow with the removal of the STT (Securities Transaction Tax) regime in favour of a flat 10% tax without any indexation benefits. The effect this will have upon the nascent SME listing platforms and the List in India initiative is still awaited. Several experts expect this to be detrimental in 2 ways:

Tax-free exits for shareholders, which has traditionally balanced the increased compliance burden of listing, may have an impact on the appetite of Startups to list

From a liquidity perspective, the effect this may have on Foreign Institutional Investors (FIIs) and domestic investors, for whom the tax-free gains would temper the inherent volatility of listed startups, is still unknown

The Finance Minister's promise to rationalise Overseas Direct Investment (ODI) will be welcomed by both Startups and Investors. If the regime is more streamlined and liberalised, this would be a great boon to the Stay in India initiative as we may see the rise of Startups with an Indian Parent and Foreign Subsidiary, instead of the current norm of a Foreign Parent and Indian Subsidiaries.

20 crore rural Indians now have access to broadband internet, with an additional 5 lakh WiFi hotspots being introduced. The wave of digitally empowered citizens will continue to drive user engagement for startups across most domains.

Consumer internet companies, in particular, will now have access to huge volumes of users in several segments, and their challenge will be to ensure that they can prove their value propositions clearly.

One of the biggest announcements of the budget was the massive health insurance programme. This scheme will give new momentum to startups in several associated domains such as insurance technology, affordable medical devices, innovations in drug delivery, and cost-effective diagnostics services.

In education, the intent to move from blackboards to digital boards is a clear signal of encouragement to edtech startups. The fundamental install base of educational infrastructure will become more robust on the back of this support, allowing startups to pursue important value propositions such as skill & content development to improve the job readiness of the Indian youth.

The announcement that the Government would seriously explore the use of blockchain tech and how it could contribute to the digitisation of the economy. This is a good statement of intent and it clarifies the role that the Government will play in this technological wave. Of particular note was the mention of Niti Aayog - the body has certainly been paying close attention to blockchain's adoption into multiple domains in the country.

The clear statement on cryptographic currencies is another strong signal to the startup ecosystem. They will not be considered legal tender so they cannot be used in financial transactions. The use of crypto-currencies in financing illegitimate activities or as part of the payment system will be also be clamped down. Much more is needed to clarify how blockchain will be utilised and adopted if startups are to move forward rapidly to build new models and unleash new value propositions.

Several low-hanging fruits which would have solved the chronic malaise enervating startups and investors were not addressed by the Finance Minister in his speech. The decisiveness demanded of this Budget, being the last one by the Modi Government, instead saw a deferment of these changes into more formal regimes which are yet to be articulated. Yet the initiatives announced sows the seeds for a digital dividend which we can hopefully harvest in the future.

Link: Budget 2018 is unclear on startup concerns, disappoints on angel tax

Budget 2018: Muted Ecstasy and Tempered Agony

Siddarth M Pai

The 2018 Budget is one of muted ecstasy and tempered agony for Startups and Investors from the lens of the Stay in India and List in India initiatives. Several low-hanging fruits which would have solved the chronic malaise enervating startups and investors were not addressed by the Finance Minister in his speech. The decisiveness demanded of this Budget, being the last one by the Modi Government, instead saw a deferment of these changes into more formal regimes which are yet to be articulated. Yet the initiatives announced sows the seeds for a digital dividend which we can hopefully harvest in the future.

This article aims to expound upon the budget for Startups and Investors and what we can expect in the coming future.

Decisions Deferred shouldn't be Decisions Denied

The ecosystem is still awaits with bated breath the promise of a specific tax regime for Angel Investors and Venture Capital Funds, which bears the burden of solving not just the minor issues, but setting the foundation for near future. The mention of angel investors in the Budget speech may signal the long-awaited decision to remove the draconian angel tax [section 56(2)(viib)]. The Finance Minister acknowledged that the Government has taken various measures to develop the and promote the Startup and Venture Capital ecosystem and decided that they require a special regime to ensure their sustained growth. We're once again left to speculate on what the new proposed regime may hold. But some of the points the industry expects include:

- Recognise Angel Investors and Angel Networks and allow them the flexibility continue without excessive regulations.
- Create an accredited investor status and exempt the investments made by them into startups from angel tax and associated measures
- Categorise securities held by a domestic fund as a capital asset only, along the lines of the allowance made to FIIs during Finance Act 2014, this removing the disadvantage placed upon domestic funds.
- Relaxation of Place of Effective Management (POEM) rules for Fund Managers, thus ensuring the flow of USD 12-16 Billion in management fees coming into India (assumed at 2% fees of 600 billion dollars in FPI, 200 Billion in venture investment, which currently invests into India but is managed from outside India for tax planning purposes).
- Allow for investors in AIFs to set off or carry forward their proportionate share of expenses incurred by the AIFs.

LTCG: Long Term Capital Gains or Long-Term Capital Gone?

The Long-Term Capital Gains exemption provided to listed equity suffered a major blow with the removal of the STT (Securities Transaction Tax) regime in favour of a flat 10% tax without any indexation benefits. The effect this will have upon the nascent SME listing platforms and the List in India initiative is still awaited. Several experts expect this to be detrimental in 2 ways:

1. **Tax-free exits** for shareholders, which has traditionally balanced the increased compliance burden of listing, may have an impact on the appetite of Startups to list
2. From a **liquidity perspective**, the effect this may have on Foreign Institutional Investors (FIIs) and domestic investors, for whom the tax-free gains would temper the inherent volatility of listed startups, is still unknown

Its still too early to predict how FIIs would react. India's strong fundamentals and staggering growth of our capital markets should hopefully allay the removal of this favourable regime, but its still an unquantifiable unknown. What would be needed today is a strong emphasis on Foundational Capital, ie, capital from domestic investors and angel investors in unlisted shares, which needs to be nurtured and treated on par with Foreign Capital, instead of being discriminated against in the current tax regime.

ODI is no longer a Test

The Finance Minister's promise to rationalise Overseas Direct Investment (ODI) will be welcomed by both Startups and Investors. If the regime is more streamlined and liberalised, this would be a great boon to the Stay in India initiative as we may see the rise of Startups with an Indian Parent and Foreign Subsidiary, instead of the current norm of a Foreign Parent and Indian Subsidiaries. By allowing grater leeway in ODI, Startups can create better structures for revenue collection and billing and Indian Investors can craft a more diversified portfolio with fewer restrictions.

The articulation of a formal Hybrid Instrument policy, a long-standing demand of the Stay in India initiative, will bring great relief to Foreign and domestic Investors. If this is harmonised with existing tax infrastructure, it can help eliminate a lot of the litigation that follows exits from these hybrid instruments.

The Seeds of a Digital Dividend

The Digital India initiative is bringing corporate India under its ambit with the launch of "Aadhar for business", a unique identifier which can harmonise the myriad numbers used to identity corporate entities in India. This way, the GSTN, PAN, TAN, CIN, LLPIN and other acronyms a corporation needs to obtain before they can start business in India will further the ease of doing business.

The digital push towards e-assessments, wherein Income Tax assessments can be handled online, can help reduce the scope for corruption tremendously and alleviate the anxiety one faces when meeting the taxman. The movement of Stamp Duty payments online along with reforms for financial instruments can further ease the conduct of business in India.

Conclusion:

Though this Budget didn't have the big-bang people always hoped for, it also lacked the consolidations direly needed by the country. The Finance Minister strived for balance and some may argue that he achieved it while others may argue against. What needs to be seen is not if this balance was achieved, but that inertia wasn't.

Link: Budget 2018: Analyis muted ecstatsy and tempered agony

Well begun is half done - Part I

A look back at how Startup India has eased the journey of Startup and Investors

Siddarth M Pai

It's been two years since the fateful 2016 budget which recognised "Startups" as a separate breed of companies unto themselves, demanding bespoke treatment from the government and authorities. The clarity brought forth helped quell the nerves of both companies and investors, who had to otherwise resort to exotic exercises, supplementary structures, and platoons of professionals to keep their entrepreneurial dreams alive.

As we all await with bated breath for the slew of reforms expected of the Finance Minister, it behoves us to see how far we've come and how much further we need to proceed so that a billion dreams may become a reality.

This article is the first part of a two-part series which explores how Startup India has eased the friction in the Startup ecosystem so far, from an investor's perspective with the second part talking about the next step of reforms which would have a multiplier effect on the ecosystem.

Flywheel of Funding

More often than not, any coverage about fundraising covers the journey of startups and entrepreneurs and the travails of raising their multimillion dollar rounds. But there exists another dimension to this story, that of fund managers raising their own funds. A large section of the investor community were elated that the government recognised this oft-ignored story and created the Rs 10,000 Cr (USD 1.5 billion) Fund of Funds managed by SIDBI which invests into SEBI registered AIFs and Venture Capital Funds.

This approach seeks to galvanise an ecosystem through a flywheel effect, instead of gardening it via direct intervention. The 10,000 Cr corpus can help seed AIFs worth Rs 60,000 Cr in India, which when fully deployed, is estimated to foment 18 lakh jobs and fund thousands of Indian startups. By contributing a maximum of 20% of the corpus of a fund, many fund managers can hasten their fundraise and concentrate more on helping their portfolio companies raise, instead of competing with them.

The Fund of Funds has invested into 88 AIFs so far, thus galvanising more than 5,600 Cr (USD 873 million) worth of investments into 472 Startups.

Bringing back tax breaks, not a back-breaking Tax

The Government's support of Indian investors found its way into the Income Tax Act, with several measures to incentivise investments into the Indian Startup ecosystem, such as:

- Insertion of Section 54 EE, which exempts Long Term Capital Gains upto Rs 50 lakhs provided it has been invested in the units of a SEBI registered AIF

- Insertion of section 54GB, which exempts Long Term Capital Gains of upto Rs 50 lakhs provided its been invested into the shares of a Startup which qualifies for section 80IAC
- Clarifying that the conversion of debentures of preference shares to equity shares will not be considered as a transfer and thus subject to capital gains at the point of conversion (the entire Venture Capital industry is based on convertible debentures and preference shares and this move has settled long standing disputes regarding the instruments of investments)
- Issuing a notification that the dreaded angel tax will not apply to shares issued at a premium to domestic investors by those startups who qualify under the DIPP scheme (although the scope of this needs to be extended to rid the spectre of angel tax that haunts various investors and entrepreneurs)
- Clarifying that the stance of the assessee in categorising the sale of listed securities held for more than 1 year as Capital Gains or Income from Business can't be questioned by the taxman
- Changing the definition of a capital asset to include any securities held by a Foreign Portfolio Investor, thus removing the friction arising from asset classification (a similar provision is sorely needed for domestic hedge funds and Category III AIFs)

Capital without Borders

The Startup India scheme over the past few years has rolled out the red carpet to foreign investors while rolling back the red tape. The success of this is evidenced by the percentage of funding foreign capital represents in the Indian startup ecosystem, which is 9 times higher than domestic capital investment.

Some of the initiatives include:

- Liberalising Foreign Direct Investment into most sectors including financial services, single brand retail, pharma, media and a host of other sectors upto 100% in most areas
- Abolishment of the Foreign Investment Promotion Board
- Relaxation of External Commercial Borrowings (ECBs) for Startups for up to USD 3 million
- Allowing for issue of shares for non-cash consideration to non-residents under the automatic route
- Marshalling foreign investment into Indian entities primarily for the purpose of investing into other Indian entities has been bought un der the automatic route as opposed to the previous government approval route
- Dismantling the approval mechanism for the transfer of securities by a Foreign Venture Capital fund to an Indian resident
- Moving most of the filings (FCGPR, FCTRS, etc) to an online window managed by the RBI (ebiz.gov.in)

Well begun is half done

The government's efforts to improve life for Startups in investors has begun to bear fruit in tangible ways as evidenced by the reduction in the number of companies seeking to have a

Delaware entity with Indian operations. The recent leapfrog in the “Ease of Business” rankings also stands testament to this.

The Government must now seek to consolidate all these gains and clarify its stance and the stance of the tax department on long pending issues which have been a bane to all startups. While we have miles to go before we sleep, we must look back and take note of what we’ve achieved before we seek to scale greater heights.

With unfailing optimism!

Well begun is half done, but not Complete – Part II

Investor Expectations ahead of Budget 2018

Siddarth M Pai

It's been two years since the fateful 2016 budget which recognised "Startups" as a separate breed of companies unto themselves, demanding bespoke treatment from the government and authorities. The clarity brought forth helped quell the nerves of both companies and investors, who had to otherwise resort to exotic exercises, supplementary structures, and platoons of professionals to keep their entrepreneurial dreams alive.

As we all await with bated breath for the slew of reforms expected of the Finance Minister, it behoves us to see how far we've come and how much further we need to proceed so that a billion dreams may become a reality.

This article is the second part of the series consisting of a retrospective of the Startup India plan so far, and prospectively what we require. The first part of the series ia available here. This second edition describes the need of the hour, which is not another set of Big Bang reforms, but a consummation and enforcement of existing policies.

Raise capital, not Regulation

The current Companies Act allows two modes of raising capital: a rights issue, which is mainly for existing shareholders to invest and maintain their shareholding and a private placement, which allows a small group of external investors to invest. Due to the rigours and fines associated with the latter, the former has become the *de facto* mode of raising capital for a lot of startups.

The fine for any missteps associated with a private placement is the lower of the capital being raised or 2 crores. Combined with the special resolutions, filing of special forms (PAS 4, PAS 5 via GNL 2), valuation reports, strict timelines, a minimum face value of investment, inability to raise from more than 50 people or use any form of media to find investors makes this route dicey for startups to raise through.

What we require is rectifications to the existing regulations, such as to:

1. Allow Startups to use angel networks and investor platforms to raise capital from Accredited Investors (more about that later on) without violating private placement norms.
2. Change the minimum threshold of Rs. 20,000 of face value to a minimum investment size of Rs. 20,000 (startups always raise at a premium, not at face value).
3. Reduce the compliance burden of multiple form filings to a simple form stating the details of the investor, proposed investment amount, and details of the securities being issued.

4. Reduce the quantum of the fine for Startups and make it applicable only if the private placement is conducted in a manner that's prejudicial to the investors and shareholders, not just for any lapse.

On the clipped wings of an Angel

2017 was brutal for angel investors in India, as witnessed by a 63% contraction in angel funding compared to the previous year. Not only were the companies they invested in subject to the dreaded Angel Tax (http://pn.ispirt.in/angel-tax-in-india%E2%80%8A-%E2%80%8Ademystified-and-explained/), but it also witnessed several Angel Networks receiving notices from the Securities Exchange Board of India (SEBI) about being unregulated stock markets and violating private placement norms. The private placement norms under the Companies Act, 2013 prohibits companies from canvassing for capital on any media and from sourcing funding from more than 50 people at a time.

Angel Networks, which are mainly groups of entrepreneurs, businessmen, executives, professionals, and others who want to give back to the ecosystem by cutting the first cheque to early stage ventures. They then go on to mentor these startups by helping them finesse their business models, craft strategy, win clients, and ultimately, raise their next round. Most early stage ventures around the world – Facebook, Google, Amazon, Flipkart, Ali Baba, Uber, etc owe their first capital infusion to these angels. The flywheel of value startups generate owe their first spark to these angels.

Countries like the US, UK, etc. recognise these angels by creating an "Accredited Investor" badge, which acknowledges these angels as sophisticated investors who are wholly aware of the risk they're taking and have a financial cushion in place in case anything goes awry. The details of this have been proposed by several stakeholders and are modelled on the same lines as the US structure.

What we need is to:

1. Recognise the contribution of Angel Investors and foster the flow of domestic capital, which constituted a mere 10% of all investment into the startup ecosystem in 2017. Angels are a vital component of a healthy startup ecosystem, and the context must be set for them to be encouraged to participate in strength if Indian startups are to continue the momentum they have generated so far.
2. Allow Angel Networks to continue as they are: as a group of willing individuals coming together and investing of their own volition; instead of scaring them with notices and marshalling them into structures subject to cumbersome compliance.
3. Create an Accredited Investor scheme which defines an Accredited Investor as having a minimum income or minimum net worth, and having them declare that they are aware of the risks of investing in early stage Startups. This is similar to the HNI (High Net-worth Individuals) scheme SEBI has for public markets, which stipulates a Rs. 10lakh investment amount to qualify as an HNI.
4. Expand the allowances made for other institutions in the private placement norms and angel tax to apply to these Accredited Investors who invest in Startups

A tax is not the best form of Defence

2017 saw the entire Startup ecosystem galvanise against the tyranny of the angel tax, a draconian measure that seeks to tax as income any securities issued at a premium and at a price greater than the Fair Market Value. Although the law says that the Fair Market Value is the higher of the valuation report or the value determined by the taxman on the date of issue, many startups have faced demand notices in spite of having followed the law and having issues securities at the price justified in their valuation report. Those who seek to fight this may ultimately prevail, but the upfront deposit of 20% of the tax payable, the time it takes to fight these matters and the sword of Damocles hanging over their head makes many entrepreneurs throw their hands up in frustration.

Even investors have to suffer adverse tax consequences, be it the inability to set off or carry forward their share of fund expenses, the differential tax treatment of domestic hedge funds (Category III AIFs) vs foreign hedge funds and Foreign Institutional Investors (FIIs), lack of clarity on the categorization of Short-Term Capital Gains as Business income or Capital Gains, or the unfavourable tax treatment meted out to domestic investors as opposed to foreign capital.

What we need is to:

1. Remove the applicability of the dreaded Angel Tax from companies who raised capital prior to the Startup India Scheme and who qualified as startups during their raise.
2. Remove the discretionary powers allowed to the taxman to disregard a valuation certificate and allow for the current law, which measures the FMV as the higher of the valuation report or the present value, to prevail.
3. Clear all pending cases of angel tax levies for companies which have a valid valuation report and not subject them to the Byzantine appeals process.
4. Categorise securities held by a domestic fund as a capital asset only, along the lines of the allowance made to FIIs during Finance Act 2014, this removing the disadvantage placed upon domestic funds.
5. Relaxation of Place of Effective Management (POEM) rules for Fund Managers, thus ensuring the flow of USD 12-16 Billion in management fees coming into India (assumed at 2% fees of 600 billion dollars in FPI, 200 Billion in venture investment, which currently invests into India but is managed from outside India for tax planning purposes).
6. Allow for investors in AIFs to set off or carry forward their proportionate share of expenses incurred by the AIFs.

Well begun is half done, but not Complete

India is the third most vibrant startup ecosystem in the world, behind the USA and China, and is still growing in a furious space. The startup phenom has seen thousands look upon entrepreneurship as a viable life choice; thousands of jobs are being created in the country and millions of dollars of value are being created in India. The Indian Government has done its fair share in easing this journey and supporting the ecosystem, which also needs to be acknowledged and celebrated by all of us.

At the eve of the upcoming budget, as many look closely at the change in tax rates or the panacea to the NPA challenge, a small group of us will be sifting through the details to discern the subtle changes, which like the beat of a butterfly’s wings, will have far-reaching ramifications for us all.
With unfailing optimism!

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TAXATION

Indian government must end triple taxation

TV Mohandas Pai and Siddarth M Pai

Misfortune comes in threes – we've often heard it appended to routine issues (missed one's alarm, missed one's ride and missed a meeting) or in deaths (C.S Lewis, Aldous Huxley and John F Kennedy), but India has taken it a step forward in applying it to taxes as well. In the era of Double Taxation Avoidance Agreements, Indian investors and shareholders are groaning under a triple taxation regime in the form of the Dividend Distribution Tax (DDT) – a fossilised remnant that has increased India's average corporate taxes and decreased India's attractiveness as an investment destination.

Evolution of Dividend Taxation

India's history with dividend taxation has been complicated – up to 1959, India used to tax dividends in the hands of the shareholders only. It followed a form of taxation known as "dividend imputation", wherein the tax paid by the Company was imputed to the benefit of the shareholder, thus enabling the shareholder to only pay the differential between the corporate tax rate & his/her marginal tax rate on the dividend income. However, due to the byzantine system of rebates, concessions, etc enjoyed by corporates, the grossing up process became subjective, leading to it being changed in 1959. Since then, the tax authorities adopted a method which promised simpler computation, but a higher tax computation; all dividends would be paid out of post-tax profits and would also be taxed in the hands of the shareholders. After liberalization, the Finance Act, 1997 bought in Dividend Distribution Tax – a 10% tax on the dividend amounts being distributed by corporates with all dividends becoming tax-free in the hands of shareholders.

The next wave of dividend tax engineering came about in the 2014 Finance Act, which stated that the dividend amount payable should be grossed up for taxes. Previously, companies would deduct 15% of the dividend amount being distributed and remit it to the government, along with the additional surcharge and cess. But from 2014, the dividend amount would need to be grossed up for taxes before it was distributed. The argument proferred by the taxman is best explained in their own words extracted from the Explanatory circular to the Finance Act 2014 (2) – "Prior to introduction of dividend distribution tax (DDT), the dividends were taxable in the hands of the shareholder… However, after the introduction of the DDT, a lower rate of 15% was applicable but this rate was being applied on the amount paid as dividend after reduction of distribution tax by the company. Therefore, the tax was computed by the company with reference to the net amount. Due to difference in the base of the income distributed or dividend on which the distribution tax is calculated, the effective tax rate was lower than the rate provided in the respective sections. In order to ensure that tax is levied on proper base, the amount of distributable income, and the dividends which are actually received by the unit holder of the mutual fund or shareholders of the domestic company, as the case may be, were required to be grossed up for the purpose of computing the additional tax."

The above word salad was graciously explained by the tax department in the form of an example in the same explanatory statements – "where the amount of dividend paid or distributed by a company is Rs. 85, then DDT under the amended provision would be calculated as follows:

Dividend amount distributed = Rs. 85
Increase by Rs. 15 [i.e. (85*0.15)/(1-0.15)]
Increased amount = Rs. 100
DDT @ 15% of Rs. 100 = Rs. 15
Tax payable u/s 115-O is Rs. 15
Dividend distributed to shareholders = Rs. 85 "

Thus in 2014 that all finance professionals and corporates were reintroduced to the elementary school mathematical concept of grossing up. The department's stance was that since the introduction of DDT in 1997, it was misapplied by corporates on the amount distributed as dividend. Instead, the DDT should be included as part of the dividend amount declared and subsequently paid out. This is illustrated in table 1. Corporate India should be happy that this change was prospective instead of retrospective, sparing them the accumulated interest, penalties and fines for lower taxes.

	Amount in INR Cr	
Particulars	**Pre 2014**	**Post 2014**
Amount declared as dividend	100	100
Grossing up for DDT @15%		117.65
DDT @ 15%	15	17.65
Add: Surcharge (12%)	1.8	2.12
Add: Cess (4%)	0.67	0.79
Amount paid to the government	17.47	20.56
Increase in taxes	**17.65%**	

Table 1

The Distortions of Dividend Taxation

The Finance Act 2016 saw the delicate balance established by the introduction of DDT in 1997 being tinkered with again. From thereon, dividend amounts in excess of Rs 10 lakhs received by an Indian resident from a company would be taxed at 10%. Thus, the same income would be taxed thrice – twice in the hands of the company via corporate taxes and DDT, and once in the hands of the shareholder in excess of 10%. The Finance Act (2) 2019 saw the introduction of the "super-rich" surcharge of 37%, further exacerbating the attractiveness of dividends. The sum total of all these changes is that dividends are taxed thrice at a cumulative rate of 47.36% of the pre-tax profits! One income. Two parties. Three taxes.

For a Company with a turnover of Rs 1,000Cr and a profit of Rs 100Cr, their tax expenses would be Rs. 25.63 Crore. Assuming they declare a 100% of their Rs 74.37 Crore post tax profits, they would need to fund an additional Rs 12.99 Crore as DDT. This drives up the effective corporate tax rate for those declaring dividends to 43.10% (25.63% corporate tax plus DDT of 17.47%, as per the grossed-up regime) thereby increasing the cost of capital for corporates. Due to the grossing up provisions, the post-tax profits would have the DDT loaded onto it, lowering the amount available for distribution to Rs 61.38 Crore. Assuming that the shareholders are in the highest tax bracket, their dividend income of Rs 61.38 Crore would cost them another Rs 8.74 Crore as tax, bringing the total tax to Rs 47.36 Crore.

The mathematical effect of this is illustrated in table 2.

Company Tax	
Particulars	**Amt (INR Cr)**
Turnover	1,000
Profit (A)	100
Tax @22%	22.00
Surcharge @12%	2.64
Cess @4%	0.99
Total Tax (B)	25.63
Effective Tax Rate	**25.63%**

Dividend Distribution Tax	
Particulars	**Amt (INR Cr)**
Gross amount available for distribution (A-B)	74.37
DDT @ 15%	11.16
Surcharge @12%	1.34
Cess @4%	0.50
Tax Amount (D)	12.99
Dividend Declared & Distributed (C-D)	61.38
Effective DDT Rate	**17.47%**

Dividend Taxation - Shareholder	
Particulars	**Amt (INR Cr)**
Dividend Amount	61.38
Taxable Dividend	61.37
Dividend Tax @10%	6.14
Surcharge @37%	2.27
Cess @4%	0.34
Tax Amount	8.74
Effective Tax Rate	**14.25%**

Table 2

The tax department’s theory on taxing the means to return gains to shareholders via dividends and buybacks was to encourage them to invest more into their business. But Corporate India doesn’t require tax disincentives to spur investments, they do so on based on available opportunities. Firms which are in a growth phase choose to reinvest their earnings so long as the cost of capital is low; firms that are mature choose to return the money back to shareholders so that they can decide to invest the money as they believe. These economic axioms have deeply ingrained in business decision making and excessive taxes distort these core principles.

It behoves the current government to step in and unravel these dividend distortions. Triple taxation is a perversion of the tax system and systematically drives up the cost of capital for Indian businesses. The fairest system is the system of dividend imputation, followed by countries like Australia and New Zealand – wherein tax is paid on the difference between the tax rate for the corporate and the tax rate for the shareholder. Barring this, either DDT or the tax paid by the shareholder should be removed or rationalised to reduce the overall tax rate to below the current 43.10% on corporates.

This government created history by removing triple talaq, corporate India hopes that the Prime Minister, Shri Narendra Modi, can boost investor sentiment by removing this pernicious form of triple taxation as well. If not, investors in Indian companies who rely on dividends will find themselves reminded of Hotel California.

“You can check out any time you like, but you can never leave!'”

Link: Indian government must end triple taxation

TAXING DIVIDEND

THE FAIREST SYSTEM IS DIVIDEND IMPUTATION, WHERE TAX IS PAID ON THE DIFFERENCE BETWEEN THE CORPORATE TAX RATE AND THE RATE FOR THE SHAREHOLDER

End triple taxation

SIDDARTH M PAI & TV MOHANDAS PAI

Siddarth is managing partner, 3one4 Capital & Mohandas is chairman, Aarin Capital Partners. Views are personal

MISFORTUNE COMES IN threes—we have often heard it appended to routine issues (missed one's alarm, missed one's ride, and missed a meeting) or in deaths (CS Lewis, Aldous Huxley, and John F Kennedy), but India has taken it a step forward, applying it to taxes as well. In the era of double taxation avoidance agreements, Indian investors and shareholders are groaning under a triple taxation regime in the form of the dividend distribution tax (DDT)—a fossil that has increased India's average corporate taxes, and decreased India's attractiveness as an investment destination.

India's history with dividend taxation has been complicated—up to 1959, dividends were taxed in the hands of the shareholders only. India followed a form of taxation known as "dividend imputation", wherein the tax paid by the company was imputed to the benefit of the shareholder, thus enabling the shareholder to only pay the differential between the corporate tax rate and his/her marginal tax rate on the dividend income. However, due to the byzantine system of rebates, concessions, etc, enjoyed by corporates, the grossing up process became subjective, leading to it being changed in 1959. Since then, tax authorities adopted a method which promised simpler computation process, but a higher computed tax amount; all dividends would be paid out of post-tax profits, and would also be taxed in the hands of the shareholders. After liberalisation, the Finance Act 1997 brought in dividend distribution—a 10% tax on the dividend amounts being distributed by corporates, with all dividends becoming tax-free in the hands of shareholders.

Finance Act 2014 stipulated that dividend amount payable be grossed up for taxes. Previously, companies would deduct 15% of the dividend amount being distributed, and remit it to the government along with the additional **tion of distribution tax by the company.** Therefore, the tax was computed by the company with reference to the net amount. Due to difference in the base of the income distributed or dividend on which the distribution tax is calculated, the effective tax rate was lower than the rate provided in the respective sections. In order to ensure that tax is levied on proper base, the amount of distributable income, and the dividends which are actually received by the unit holder of the mutual fund or shareholders of the domestic company, as the case may be, were required to be grossed up for the purpose of computing the additional tax."

The above word salad was graciously explained by the tax department as an example—"where the amount of dividend paid or distributed by a company is ₹85, then DDT under the amended provision would be calculated as follows:
Dividend amount distributed = ₹85
Increase by ₹15 [i.e. (85*0.15)/(1-0.15)]
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DDT @ 15% of ₹100 = ₹15
Tax payable u/s 115-O is ₹15
Dividend distributed to shareholders = ₹85"

Thus, in 2014, all finance professionals and corporates were reintroduced to the elementary school mathematical concept of grossing up. The department's stance was that since the introduction of DDT in 1997, it was misapplied by corporates on the amount distributed as dividend, and should instead be included as part of the dividend amount declared and subsequently paid out. This is illustrated in the accompanying graphic. Corporate India should be happy that this change was prospective instead of retrospective, sparing them the accumulated interest, penalties, and fines for lower taxes.

The Finance Act 2016 saw the delicate balance established by the introduction of DDT in 1997 being tinkered with again. Thereon, dividend amounts in excess of ₹10 lakh received by an Indian resident from a company would be taxed at 10%. Thus, the same income would be taxed thrice—twice in the hands of the company via corporate taxes and DDT, and once in the hands of the shareholder in excess of 10%. The Finance Act (2) 2019 saw the introduction of the "super-rich" surcharge of 37%, further exacerbating the attractiveness of dividends. **The sum total of all these changes is that dividends are taxed thrice at a cumulative rate of 47.36% of the pre-tax profits! One income. Two parties. Three taxes.**

For a company with a turnover of ₹1,000 crore and a profit of ₹100 crore, tax expenses would be ₹25.63 crore. Assuming they declare a 100% of their ₹74.37 crore post tax profits, they would need to fund an additional ₹12.99 crore as DDT. This drives up the effective corporate tax rate for those declaring dividends to 43.10% (25.63% corporate tax plus DDT of 17.47%, as per the grossed-up regime), thereby increasing the cost of capital for corporates. Due to the grossing up provisions, the post-tax profits would have the DDT loaded on to it, lowering the amount available for distribution to ₹61.38 crore. Assuming that the shareholders are in the highest tax bracket, their dividend income of ₹61.38 crore would cost them another ₹8.74 crore as tax, bringing the total tax to ₹47.36 crore *(see graphic)*.

The tax department's motive on taxing the means to return gains to shareholders via dividends and buybacks was to encourage them to invest more into their business. But, corporate India doesn't require tax disincentives to spur investments, they do so based on available opportunities. Firms which are in a growth phase choose to reinvest their earnings so long as the cost of capital is low; firms that are mature choose to return the money back to shareholders so that they can decide to invest the money as they believe. These economic axioms are deeply ingrained in business decision making, and excessive taxes distort these core principles.

It behoves the current government to step in and unravel these dividend distortions. Triple taxation is a perversion of the tax system, and systematically drives up the cost of capital for Indian businesses. The fairest system is the system of dividend imputation, followed by countries like Australia and New Zealand, wherein tax is paid on the difference between the tax rate for the corporate and the tax rate for the shareholder. Barring this, either DDT or the tax paid by the shareholder should be removed, or rationalised to reduce the overall tax rate on corporates to below the current 43.10% level.

This government created history by removing triple *talaq*, corporate India hopes that the prime minister, Narendra Modi, can boost investor sentiment by removing this pernicious form of triple taxation as well. If not, investors in Indian companies who rely on dividends will find themselves reminded of *Hotel California* by The Eagles.
"You can check out any time you like, But you can never leave!"

FINANCIAL EXPRESS Thu, 21 November 2019 https://epaper.financialexpress.com/c/49002149

Need to revisit anti-Indian taxation laws

TV Mohandas Pai and Siddarth M Pai

We live in an age of protectionism. An age where local industries are being protected against global players. The glut of globalisation from the 90s now faces a resurgent spirit of nationalism; policies that previously promoted free-trade are being met with protective measures such as tariffs and trade barriers. The US, the bastion of free trade and capitalism, has started a brutal trade war with China and has gone so far as to create checks on foreign acquisitions of US companies via the Committee on Foreign Investment in the United States - all to promote local industries under the "America First" policy.

In this protectionist era, instead of giving Indian investors an advantage for investing in India, our tax laws have impeccably handicapped Indian investors in their own country!

The 2019 budget saw the introduction of a 37% surcharge on incomes above Rs 5 crore earned in India – but the fine print saw this surcharge being applied to trusts as well as individuals. Many foreign and domestic institutional investors are incorporated as trusts since it gives them the greatest flexibility to manage their investments. This surprise surcharge caused panic in the markets and blood on the street. July witnessed a haemorrhage of over Rs 14 lakh crore in market value with FPIs pulled out over 22,000 crores. The Finance Minister took cognizance of this after the consequences of this became too much to bear and vowed to introduce mitigative measures. Last Friday, she announced a series of measures to bring relief to the market and the economy, with the chief amongst these measures was a rollback of the higher surcharges for FPIs.

While the foreign investors were celebrating this, Indian investors were left aghast at being left in the lurch and being subject to the same surcharge that their foreign counterparts were exempt from. But this discrimination is nothing new – Indian investors have consistently been treated as subordinate to foreign investors, beginning from how our laws are drafted.

For investors in the Indian markets, there always existed an ambiguity in taxation – whether the gains they make are capital gains - having a more favourable tax regime, whether those gains should be considered as business income. There are innumerable cases on this subject involving inspections of the business model, different demat accounts, investor intention, etc yielding a lot of ambiguity. In 2014, the then Finance Minister Shri Arun Jaitley spoke about the "uncertainty in taxation on account of characterization of income" faced by FPIs, causing him to amend the definition of a "capital asset" to include any securities held by an FPI – ending this debate for FPIs.

Yet Indian investors didn't receive the same courtesy for the same issue faced by them.

In all fairness, in February 2016, the CBDT did issue a circular stating that it will accept the stance of the investors as to whether the securities are stock-in-trade or capital assets if it's held for longer than 12 months. But in terms of assets held for less than 12 months, the ambiguity for Indian investors continues whereas their foreign counterparts stand relieved.

This issue is especially acute in Category III AIFs, who will be the most hit by the increased surcharge. Out of the 3 categories of Alternative Investment Funds in India, Category III AIFs are those “which employ diverse or complex trading strategies” investing into listed or unlisted securities. But they lack the pass-through structure afforded to the other AIFs in India and suffer taxation at the maximum marginal rate. Worse off, due to our tax codes, if they choose to employ derivatives in the form of futures and options, their income will be taxed at the maximum marginal rate as business income, which is now 42.7%. The FPIs who do the same do not suffer from this rate since they’re exempt from the surcharge and their derivatives are capital assets.

The lack of pass-through status for CAT III AIFs flies in the face of logic when the other two categories are afforded this. These funds are all pooling vehicles – an accumulation of funds from various investors for common investments under common management. The just form of taxation is to ascribe the tax rates of the individual investor from the income generated by the fund. Taxing the income at the maximum marginal rate because of the common vehicle is absurd. To put things in perspective, this is akin to taxing the savings bank interest of a person with a net income of Rs 10 lakhs and a person with a net income of Rs 10 crore at the same rate just because they both use the same bank! The law cannot turn a blind eye to the end beneficiary and assume that all investors belong to the highest tax slab regardless of their actual income. To each his own rate.

This begs the question to all fund managers that for a given strategy and structure, should the choice be to create an Indian vehicle - which suffers from the deficiencies of higher taxes, ambiguity over the classification of gains and characterisation of derivative gains as business income or float a foreign fund, register as an FPI rid oneself of these issues? Ceterus paribus, if a change in geography yields such benefits, why would anyone create an Indian fund to invest into India?

This is one of the reasons why foreign investors are reluctant to invest in Indian investment vehicles, given all these restrictions. India’s CAT III AIFs (including hedge funds) have a corpus of only Rs 40,000Cr ($5.52 billion). To put things in perspective, the largest hedge fund in the world has assets under management of $6.3 trillion and the 10th largest has over $34.3 billion. How can India become an investment destination when it laws are categorically loaded against it’s domestic funds? This discrimination is especially puzzling to foreign investors who are looking to back Indian fund managers in India; instead, they’re found in either Mauritius or Singapore.

Even in the unlisted space, discrimination exists in the form of ‘Angel Tax’ or Section 56(2)(viib) – which taxes the premium of Indian investments into private companies as income if such premia exceed the fair market value. It’s pertinent to note that this applies only to Indian investors and not to money received from foreign investors. This is one of the reasons why rupee participation in the Indian startup story is under 10% of the total capital raised by them.

It must be noted that the reports being circulated that Smt. Nirmala Sitharaman created this disparity in taxation are thoroughly untrue. Such disparity has existed for a long time and continues to do so. It’s a tragedy that Indian investors are discriminated like this in their own country. In spite of this discrimination, since the budget speech in 2019, domestic Investors have been net buyers to the tune of Rs 38,000 Cr while foreign investors were net sellers. Domestic participation in the market has been higher than ever before and the government should recognise this. We need our elected representatives to correct this discrimination in our laws. We need Prime Minister Modi to unleash the animal spirits of the Indian investor and end this discrimination. Allow for securities held by CAT III AIFs to be classified as "capital assets" and extend the same benefit to them as was extended to FPIs. Did we gain independence from the British only to still be discriminated in our own country?

Indian fund managers still look forward to the day when the gateway to Indian equities is Mumbai – not Mauritius.

Link: Tax reforms: Need to revisit anti-Indian taxation laws

● TAX REFORM

THE EXCLUSION OF CAT III AIFs FROM THE ROLLBACK OF SURCHARGE ON FPIs LEAVES INDIAN FUNDS AT A FUNDAMENTAL DISADVANTAGE IN INDIA COMPARED WITH FPIs

Need to relook anti-Indian tax laws

TV MOHANDAS PAI & SIDDARTH M PAI

Mohandas Pai is Chairman, Aarin Capital & Siddarth Pai is Founding partner, 3one4 Capital

Views are personal

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For investors in Indian markets, there always existed an ambiguity in taxation regarding whether the gains they make are capital gains—having a more favourable tax regime—or should be considered as business income. There are innumerable cases on this subject involving inspections of the business model, different demat accounts, investor intention, etc, yielding a lot of ambiguity. In 2014, then-FM Shri Arun Jaitley spoke about the "uncertainty in taxation on account of characterisation of income" faced by FPIs, causing him to amend the definition of a "capital asset" to include any securities held by an FPI—ending this debate for FPIs.

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In all fairness, in February 2016, the CBDT did issue a circular stating that it will accept the stance of investors on the issue of whether securities are stock-in-trade or capital assets if they're held for longer than 12 months. But, in terms of assets held for less than 12 months, the ambiguity for Indian investors continues whereas their foreign counterparts stand relieved.

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How simplifying capital gains tax regime will help both investors and the income-tax department

TV Mohandas Pai and S Krishnan

Long-term capital gains (LTCG) arising from the transfer of a long-term capital asset are either taxed at a concessional rate in India or exempt from taxation on meeting some preconditions.

It was recently reported in the media that there are anomalies in the processing of I-T returns at the IT department's Central Processing Centre, resulting in incorrect computation of tax liability on capital gains. It's not surprising, since taxation of capital gains is one of the most complex regimes to understand. Holding periods are different for various types of assets. Tax rates are different for short-term and long-term gains and are different for various assets.

Exemptions are provided on meeting some preconditions and withdrawal of those exemptions when the preconditions are not met. In addition, some specified categories of long-term capital assets get the benefit of cost-inflation indexation, whereby the base cost of the asset is increased by the ratio of inflation in the year of sale and purchase. The rules for carry-forward and set-off are also not uniform. Short-term capital loss, which is carried forward from earlier years, can be adjusted against long-term capital gains as well as short-term capital gains, whereas long-term capital loss can be adjusted only against long-term capital gains!

The tax rates and the tenure to determine long-term capital asset

Nature of asset	STCG tax rate	LTCG tax rate	Holding period for LTCG
Unlisted shares of a company	Regular income-tax rates applicable to various tax payers	**20%** with indexation benefit	24 months
Equity shares listed on a recognised stock exchange in India before February 1, 2018; applicable STT is paid; A unit of an equity oriented mutual fund	**15%**	If sold on or after April 1, 2018, 10% on LTCG exceeding ₹ 1 lakh. Capital gains up to January 31, 2018 is tax exempt. No indexation benefit	12 months
Equity shares listed on a recognised stock exchange in India after January 31, 2018; applicable STT is paid	**15%**	If sold on or after April 1, 2018, 10% on LTCG of more than ₹1 lakh. Indexation benefits apply. Cost will be indexed up to FY17-18	12 months
Equity shares listed on a recognised stock exchange in India on which STT is not paid (off-market transactions)	Regular income-tax rates applicable to various tax payers	**20%** with indexation benefit or 10% without indexation benefit, whichever is lower	12 months
Preference shares or non-convertible debentures listed on a recognised stock exchange in India (No STT is payable on a preference share or a non-convertible debenture)	Regular income-tax rates applicable to various tax payers	**20%** with indexation benefit or 10% without indexation benefit, whichever is lower	12 months
Units of debt mutual funds	Regular income-tax rates applicable to various tax payers	**20%** with indexation benefit or 10% without indexation benefit, whichever is lower	36 months
Immovable property being land or building or both	Regular income-tax rates applicable to various tax payers	**20%** with indexation benefit	24 months

In addition to income-tax, surcharge and cess as applicable are chargeable on the above tax rates

Long-term capital gains (LTCG) arising from the transfer of a long-term capital asset are either taxed at a concessional rate in India or exempt from taxation on meeting some preconditions.

A long-term capital asset is defined by the period of holding such capital asset. The de facto holding period for a long-term capital asset in India is more than 36 months immediately preceding the date of its transfer. However, this de facto period is modified for various types of assets. In the case of a share listed on a recognised stock exchange in India, the holding period is 12 months, while it is 24 months in the case of an unlisted share. The holding period in case of a debenture listed on a recognised stock exchange in India is 12 months, while it is 36 months for unlisted debentures. In the case of an equity-oriented mutual fund unit, the holding period is 12 months, while it is 36 months for a debt-oriented mutual fund unit. An immovable property being land or building or both is considered long-term if the holding period is 24 months. The capital gains tax rate is different for short-term and long-term assets, depending on the type of capital asset and payment of applicable securities transaction tax (STT). The accompanying table provides a summary of the tax rates and the tenure to determine long-term capital asset.

The LTCG exemption regime is further complicated with too many rules and restrictions and is not uniformly applicable for all taxpayers. An individual or a HUF generating LTCG on transfer/sale of an existing residential house property is exempt to the extent the LTCG is used to buy or construct maximum of two new houses (residential property). However, LTCG on the sale of existing house property must not exceed 2 crore. The new properties must be purchased either one year before the sale or two years after the sale of the property. Or the new residential properties must be constructed within three years of the sale of the property. If the taxpayer is not able to use the capital gains to buy or construct new houses before the date of furnishing of the return of income, he or she should deposit the amount in the Capital Gains Accounts Scheme (CGAS), else the gains become taxable. This benefit can be claimed only once in the lifetime by an individual or a member of HUF. If full amount of LTCG is not reinvested, then pro rata relief is available.

LTCG arising on transfer of any capital asset not being a residential house is exempt from taxation if the taxpayer, being an individual or a HUF, has within a period of one year before or two years after the transfer date purchased, or within a period of three years after that date constructed one residential house in India. If full amount of LTCG is not used for the purchase or construction, then pro rata relief is available. The taxpayer will not be entitled to LTCG exemption if he or she (1) owns more than one residential house, other than the new asset, on the date of transfer of the original asset; or (2) purchases any residential house, other than the new asset, within a period of one year after the date of transfer of the original asset; or (3) constructs any residential house, other than the new asset, within a period of three years after the date of transfer of the original asset. If a taxpayer within six months from the sale of land or building or both (residential or non-residential) has invested LTCG in long-term specified bonds issued by NHAI and REC or by the central government for a minimum period of five years, such LTCG shall be tax exempt to a maximum of Rs 50 lakh. This exemption is available to any person. All of these are confusing to ordinary taxpayers, forcing them to seek professional help.

The finance minister, earlier this year, simplified the corporate tax regime by introducing two low-tax rates associated with no deductions and exemptions. A similar approach should be adopted for capital gains tax regime. An exclusive capital gains tax regime should be introduced for financial assets, whereby investments in equity and debt securities, whether listed or not, should be taxed in a uniform manner.

Various types of financial assets carry risks associated with returns. Defaults in interest payment of debt securities in India in the recent past indicate that debt securities also carry significant risk. There is no rationale for debt securities to be considered as long-term capital assets after a holding period of 36 months, instead of 12 months applicable for listed equity securities and equity mutual fund units. It is similar for the difference in tax rates. To take benefit of lower tax rates of equity securities, many investors opt to invest in arbitrage funds/hybrid funds, with the justification that the risk is similar to a debt fund and its taxation is similar to an equity fund, thereby possibly generating higher post-tax returns. Investments in unlisted equity shares carry higher risks compared to listed equity shares. However, the holding period is 24 months for unlisted shares to qualify as a long-term capital asset and the tax rate is higher at 20% with indexation benefit. There is no rationale for this difference.

To rectify this anomaly, all investments in financial assets should be considered as long-term capital assets after 12 months of holding. Income-tax rate of 10% with an exemption up to `1 lakh should be extended to LTCG from all financial assets. Income-tax rate of 15% should be applicable for short-term capital gains from all financial assets. To incentivise investments in start-up companies, a tax deduction of 50% should be provided in the year of investment. Consequently, investments in listed and unlisted equity shares and debentures, and equity and debt mutual fund units, would be taxed in a similar manner. This will enable investors to choose investments based on risk and reward suitable to them, rather than driven by tax considerations.

Immovable property, being land or building, is considered long-term capital asset if held for a period of more than 24 months. LTCG from transfer of immovable property is subject to taxation at 20% with indexation benefits. The option of taxation at a lower rate of 10% without indexation benefit should also be extended to immovable property, which would then be similar to the rate applicable to financial assets. The lower tax rate of 10% would make the real estate sector attractive for investments, thereby helping real estate builders to reduce the volume of unsold inventory. A simple capital gains tax regime will help investors in compliance and the income-tax department in administration.

Link: How simplifying capital gains tax regime will help both investors and the income-tax department

ILLUSTRATION: ROHIT PHORE

TV MOHANDAS PAI & S KRISHNAN

Pai is chairman, Aarin Capital Partners, and Krishnan is a tax consultant

Simplifying capital gains tax regime

A simple capital gains tax regime will help investors in compliance and the income-tax department in administration

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To rectify this anomaly, all investments in financial assets should be considered as long-term capital assets after 12 months of holding. Income-tax rate of 10% with an exemption up to ₹1 lakh should be

India's Investment Trust Deficit

Siddarth M Pai and Vishak Nathan

Those who track the markets during the budget speech can attest to the inordinate sway every word can have on the market. The Finance Minister's statements that the government does not "look down upon legitimate profit earning" and the proposal of "a number of initiatives as part of a framework for kick-starting the virtuous cycle of domestic and foreign investments" during the early parts of the speech rallied the market, who were anticipating several much-needed measures to galvanise investments in the country. The proposed measures such as easier KYC norms for FPIs, increased FDI limits, opening up new investment vehicles for foreign participation hold a lot of promise for the future. But the rudest shock came when the Finance Minister discussed revenue mobilisation measures and the increased surcharge on incomes above Rs 2 crore.

A tax on the super-rich was expected, with rumours about such measures doing the rounds before the budget. But what was especially shocking was to extend this not only to individuals but to all association of persons and trusts – whether domestic or foreign. And therein as the bard would tell us, lies the rub.

Many Foreign Portfolio Investors consist of pension funds, insurance funds, etc who are incorporated as trusts. This highlights the fiduciary responsibility they have towards their thousands of beneficiaries and the governance norms that they must adhere to. Their structure also allows them to pass-through the gains to their beneficiaries – people who rely on this income to sustain themselves in their retirement. But as per the latest proposals, they're going to suffer a surcharge that is much higher than that attributed to foreign companies and which turns a blind eye to their pass-through status. The very structure adopted by these FPIs renders them liable to tax at much higher effective rates than foreign corporations. These measures run the risk of countering efforts to facilitate greater foreign participation in structures such as REITS, Invits, etc.

This also adversely affects Indian Category III AIFs, who are already reeling from an 18% GST on fees which cannot be claimed as well as the lack of any pass-through status for any income. Most of them are also structured as trusts as it offers the greatest flexibility and is the most tax effective structure. Indian tax laws tax any business income of a trust at the maximum marginal rate and treats gains from hedging instruments such as futures and options as business income. This renders all income from any CAT III AIF being taxed at 42.7%! Hedge funds across the world have pass-through status thus allowing any gains to be taxed in the hands of the investors as though they invested directly into the underlying portfolio, something Indian hedge funds were denied since 2014. CAT III AIFs in India have long suffered under an unfair tax regime with ambiguity abound. Though the government has taken great pains in addressing the needs of FPIs, even amending the definition of the term "capital asset" to include any securities held by an FPI, no such generosity has been extended to Indian investors. While India seeks greater domestic capital participation in the country, its own tax laws cripple investor appetite due to such draconian measures.

A pass-through status for pooling vehicles such as CAT III AIFs and trusts is a just form of taxation as it follows the principle of ascribing tax rates as per the individual investor's income. A common investment pooling vehicle cannot imply the highest tax rate to its investors. To put things in perspective, this is akin to taxing the savings bank interest of a person with a net income of 10 lakhs and a person with a net income of 10 crore at the same rate just because they both use the same bank! The law cannot turn a blind eye to the end beneficiary and assume that all investors belong to the highest tax slab regardless of their actual income. To each his own rate.

The impact of this proposal on investor sentiment is visible to all. The markets shed over 1000 points over the past 3 days, lead primarily by FPIs who're looking to rethink their India strategy. Many domestic fund managers have reached out to the government to plead their case.

The budget speech did not intend for this distortion. The honourable Finance Minister stated, and I quote, "I, therefore, propose to enhance surcharge on individuals having taxable income from 2 crore to 5 crore and 5 crore and above". Thus, this is an unintended, inadvertent consequence to tax FPIs and CAT III AIFs with these surcharges which deserves to be rectified immediately.

The government cannot roll out the red carpet to investors, then bolt the door and shake them down for all they are worth.

India requires investments of at least $ 300 billion a year as per the 2019 budget speech. With a savings rate of 10% of our GDP of $ 2.7 trillion, India needs capital from all sources to meet its investment needs. Our ratio of foreign investment to GDP is already low compared to other large economies worldwide. In order to become a $ 5 trillion economy by 2025, India needs a growth rate of 12% and access to low-cost capital. But the proposed measures of lop-sided surcharges and the mistreatment of Indian investment vehicles will make these proposals the architect of its own misery.

Link: India's investment trust deficit

TAX BURDEN

THE RISE IN TAX ON INDIAN CAT III AIFS ANNOUNCED IN THE BUDGET DISCOURAGES GREATER DOMESTIC CAPITAL PARTICIPATION

India's investment **trust deficit**

SIDDARTH PAI & VISHAK NATHAN

Pai is founding partner 3one4 Capital
Nathan is founder Suvitta Capital
Views are personal

THOSE WHO TRACKED the markets during the Budget speech can attest to the inordinate sway every word can have on the market. The finance minister's statement that the government does not "look down upon legitimate profit earning" and the proposal of "a number of initiatives as part of a framework for kick-starting the virtuous cycle of domestic and foreign investments" during the early parts of the speech rallied the market, which was anticipating several much-needed measures to galvanise investments in the country. The proposed measures, such as easier KYC norms for FPIs, increased FDI limits, opening up new investment vehicles for foreign participation, etc, hold a lot of promise for the future. But, the rudest shock came when the finance minister discussed revenue mobilisation measures and the increased surcharge on incomes above ₹2 crore.

A tax on the super-rich was expected, with rumours about such measures doing the rounds before the Budget. But, what was especially shocking was that this was extended not only to individuals but also to all association of persons and trusts—whether domestic or foreign. And therein, as the bard would tell us, lies the rub.

Many foreign portfolio investors consist of pension funds, insurance funds, etc, that are incorporated as trusts. This highlights the fiduciary responsibility they have towards their thousands of beneficiaries and the governance norms that they must adhere to. Their structure also allows them to pass-through the gains to their beneficiaries—people who rely on this income to sustain themselves in their retirement. But, as per the latest proposals, they're going to suffer a surcharge that is much higher than that attributed to foreign companies and which turns a blind eye to their pass-through status. The very structure adopted by these FPIs renders them liable to tax at much higher effective rates than foreign corporations. These measures run the risk of countering efforts to facilitate greater foreign participation in structures such as REITS, InvITs, etc.

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Modi govt incentivises Risk Takers and Entrepreneurs

TV Mohandas Pai and S Krishnan

India's Finance Minister (FM) Mrs. Nirmala Sitharaman slashed the corporate income tax (CIT) for domestic companies to 22% in order to promote growth and investment, and announced a new CIT of 15% for new domestic manufacturing companies thereby providing a boost to 'Make-in-India' programme. The new effective CIT would be 25.17% inclusive of a new lower surcharge of 10% and cess of 4%. With this announcement, the Modi government fulfilled the promise made by the former FM in FY 2015-16 of a CIT of 25% with no exemptions/incentives and provided a fillip to manufacturing companies with a lower 15% CIT. It is the for the first time that the Government of India has used an Ordinance to slash IT rates outside the conventional Budget.

India's CIT is now closer to worldwide average statutory CIT of 23.03%. A study conducted by Tax Foundation, a tax policy non-profit organization based in the U.S., on the CIT rates across 208 tax jurisdictions in 2018 revealed that India had the highest CIT @ 35% amongst the large economies in the world. The study further indicated the average statutory CIT rate is 20.65% in Asia, 28.40% in BRICS, 21.86% among EU countries, 23.93% in OECD countries and 27.63% in the G7 which comprises of the seven wealthiest nations in the world. The USA has a combined statutory rate of 25.84%. The majority of the 208 separate jurisdictions surveyed have corporate tax rates below 25% and 103 have tax rates between 20 and 30%.

Before the CIT rate cut, the marginal CIT for FY 2019-20 was 35% for companies having turnover above Rs. 400 crs in FY 2017-18, and dividend distribution tax (DDT) of 20.56%. The table below indicates that these companies had to earn pre-tax income of over 27% in FY 2019-20, by investing, running a business and creating jobs to enable investors in that company to earn a post-tax dividend of 12%. After the CIT reduction, it has to earn a pre-tax income of 23.50%, an absolute reduction of 3.50%. A sole proprietor of a business earning more than Rs. 5 crs in FY 2019-20, has to earn only around 21% to get the same return, disincentivising scale! In comparison, a company in USA with an effective CIT of 25.85% has to earn a pre-tax income of 20.22% in CY 2019 to enable an investor to earn a post-tax dividend of 12%.

Pre-tax return required to generate 12% post-tax income			
	FY 2019-20[1]	**FY 2019-20[2]**	**FY 2013-14**
Equity investment (Rs. in crore)	100	100	100
Profit Before Tax (Rs. in crore) (A)	23.52	27.05	21.90
Pre-tax Return On Equity (%) (derived figure to get to after tax ROE of 12%)[3]	**23.52**	**27.05**	**21.90**
Corporate tax rate (%) (B)	**25.17**	**34.94**	**33.99**
Corporate tax paid (Rs. in crore) (C = A * B)	5.92	9.45	7.44
Profit After Tax (Rs. in crore) (D = A - C)	17.60	17.60	14.46

Dividend Distribution Tax rate (%) (E)	20.56	20.56	17.00
Dividend Distribution Tax paid (Rs. in crore) (F = D * E)	3.62	3.62	2.46
Dividend paid to shareholders (Rs. in crore) (G = D - F)	13.98	13.98	12.00
Dividend Tax – High Net worth Individual (%) (H)	14.25	14.25	0.00
Dividend Tax paid by HNI (Rs. in crore) (I = G * H)[4]	1.98	1.98	0.00
Net return (dividends) to shareholders (Rs. in crore) (J = G - I)	12.00	12.00	12.00
Total tax to Govt. (Rs. in crore) (K = C + F + I)	11.52	15.05	9.90
Total Tax to Govt. (% to PBT) (L = K/A)	**48.98%**	**55.64%**	**45.21%**

Note:
1. After the CIT rate cut on 20th September 2019. CIT @ 22%; surcharge @ 10% and Health and education cess at 4%. Effective tax rate (ETR) is 25.17%.
2. Before the CIT rate cute. CIT @30%; surcharge @ 12% and Health and education cess at 4%. ETR is 34.94%.
3. A net return of 12% to shareholders is considered by summing up the government of India bond rate of 6.5% to 7% and an average risk premium on equity of 5%.
4. It is assumed that an individual having a total annual income of more than Rs. 5 crore has invested in a private company and the entire dividend received is more than Rs. 10 lakhs.

Before the CIT cut, India was collecting total tax of about 55.64% on the Profit before Tax (PBT) whereas USA collected a total tax of 40.67%! The tax collected by India on PBT increased by 52% between FYs 2013-14 and 2019-20 forcing companies to generate a higher pre-tax income to enable an investor to earn the same post-tax dividend. The compulsion to generate a very high return imposes a high cost on the economy, reduces money for reinvestment, disincentivises investment and makes India a Rent Seekers Economy, always intent on avoiding taxes!

The high CIT had increased the cost of capital thereby making Indian companies globally uncompetitive. Cost of capital is the hurdle rate below which no company would be able to run a sustainable business. The weighted average cost of capital (WACC) in India is around 12% considering 10yr G-Sec rate of 6.5% to 7% and average risk premium on equity of 5%. The U.S. WACC is 7%, Europe is 7.16% and Globally 7.9% (Prof. Aswath Damodaran, Stern School of Business, NYU).

Indian companies are unable to compete globally when their cost of capital and CIT is significantly higher than its overseas competitors. When overseas companies with lower cost of capital invest and operate in India, they dominate. In addition, Indian companies become a prime target for acquisition by global companies which have a lower cost of capital. It is one of the major reasons why our entrepreneurs were selling out their companies being unable to fight the battle of WACC!

Prime Minister Narendra Modi in his 2019 Independence Day speech recognized the role and contribution of wealth creators in India. He said, “Wealth creators should not be viewed with suspicion. They are the wealth of the nation. It is necessary that those who create wealth in the country should be equally respected and encouraged.” Wealth creators and the entrepreneurs are the ones who take the risk, invest and create jobs. One big issue deterring the risk takers was the high taxes on capital in India which had gone up further in FY 2019-20 with the increase in surcharge for High Net-worth Individuals (HNI) who are major investors, as well as tax terrorism on an unprecedented scale.

Individuals having an income of more than Rs. 1 cr are subject to IT surcharge between 15% to 37% resulting in high tax rates of 35.88% to 42.74%! They pay IT at rates varying between 11.96% to 14.25% on dividend income exceeding Rs. 10 lakhs and long-term capital gains (LTCG) tax of 12% to 14.25% on gains exceeding Rs. 1 lakh from listed companies. If the investment is in an unlisted company, the IT is 24% to 28.50%, after considering the indexation benefits. In a listed company, LTCG arises after 12 months while it is 24 months for unlisted securities, so much for incentivising investment! The risk on unlisted securities is higher due to lack of liquidity and inadequate price discovery but taxes are more. In India, higher the risk, higher is the tax! Along with the CIT reduction, the FM has also provided some relief to high income earners by withdrawing the enhanced surcharge applicable on capital gains arising on sale of equity shares/units of an equity mutual fund that are liable to Securities Transaction Tax. But the enhanced surcharge on dividend income continues.

Imposition of DDT and the additional tax on individuals on dividend income beyond Rs. 10 lakhs resulted in multiple levels of dividend taxation. Distribution of dividends is another form of return of capital and tax rate on dividends is generally linked to the capital gains tax rate. A higher dividend tax relative to the capital gains tax could discourage companies from distributing earnings through dividends. A reduction in the effective DDT to 15% and withdrawal of taxation of dividends beyond Rs. 10 lakhs will increase the return to investors and incentivise them towards higher investments.

Reduced taxes will reduce the pressure on companies to generate higher returns, improve the risk-return trade-off for investors and increase investment. Limiting the CIT ETR at 25.17% is enabling Indian companies to provide a risk-adjusted return of 12% to its shareholders at a lower pre-tax income of 23.5% compared to 27% before the rate cut. It will also improve the liquidity for banks and financial institutions for lending and enable them to reduce lending rates. This should increase the capital efficiency of the economy and provide the much-needed growth impetus for India!

Link: Modi govt's tax cuts will incentivise entrepreneurs, risk takers


TV MOHANDAS PAI
& S KRISHNAN
Pai is chairman, Aarin Capital Partners; Krishnan is a tax consultant

MODI GOVERNMENT

Incentivising risk-takers, entrepreneurs

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FINANCE MINISTER Nirmala Sitharaman has slashed the corporate income tax (CIT) for domestic companies to 22% in order to promote growth and investment, and announced a new CIT of 15% for new domestic manufacturing companies, thereby providing a boost to the Make-in-India initiative. ...

Pre-tax return required to generate 12% post-tax income

FINANCIAL EXPRESS

NDA has failed to end tax terrorism, legacy problems

TV Mohandas Pai and S Krishnan

A major promise made by the BJP in 2014 was to stop tax terrorism. Former finance minister Arun Jaitley had proclaimed, before the 2014 election, that tax terrorism is the biggest threat to India and he was going to stop it. The party's 2014 manifesto stated, "UPA Government has unleashed 'tax terrorism' and 'uncertainty', which not only creates anxiety amongst the business class and negatively impacts the investment climate, but also dents the image of the country. We will provide a non-adversarial and conducive tax environment, overhaul the dispute resolution mechanisms, rationalisation and simplification of the tax regime which is currently repulsive for honest tax payers."

A review of NDA II (2014-19) indicates that it has been unable to fulfil these promises. The Receipt Budget FY20 indicates that, at the end of Reporting Year 2017-18, taxes on income not under dispute stood at just `1.09 lakh crore compared to `6.24 lakh crore under dispute, (about 5.7 times that not under dispute)! About 50% of the outstanding disputes have come up in the last two years. Tax terrorism arises from unrealistic target-setting, leading to high-pitch assessments, lack of reviews by superiors of such assessments, unbridled power to tax officers, slow-moving courts, time consumed in settling appeals and retrospective amendments of tax laws. While the NDA II took steps to reduce tax terrorism, the on-ground impact has been poor.

The large quantum of pending disputes show that high-pitch assessments continue. As per the CBDT's annual Central Action Plans, about appeals pending with the Commissioners of Income-tax (Appeals) have risen from 2.15 lakh appeals in March 2014 to about 3.41 lakh appeals in March 2019. The demand involved in appeals in FY19 is `5.71 lakh crore, of which demands for ~`1.16 lakh crore have been stayed by Income-tax Appellate Tribunals (ITAT)/Courts. Jaitley had promised that disputes would fall, but facts indicate otherwise. To achieve the unrealistic targets set for them, officers (mis)use the litigation mechanism. The corporate sector is the taxman's favourite whipping boy. Tax officers tell many corporates that they have a target, they know they are wrong, and then make the corporates pay taxes against high-pitch assessments, tell them to appeal while assuring the latter that they will get refunds in appeal. In some instances, they have even frozen corporates' bank accounts to force them to pay advance tax! Look at the balance-sheets of the top 30 ethical companies in India. Contingent liabilities created because of tax disputes tell their own story. As per Receipt Budget FY20, in Reporting Year 2017-18, the corporation tax amount under dispute, at `3.99 lakh crore, is 5.8 times the corporation tax not under dispute (`0.69 lakh crore).

This ratio was lower, at 3.7, in Reporting Year 2013-14. What started in the UPA era has risen under NDA II—a failure of the political leadership! The political leadership seems to have become victims of tax officers and has lost sight of its duty to protect honest citizens from perverse assessments. Tax justice has broken down!

Tax officers needlessly pursue appeals at higher levels, regardless of the outcome, since there is no penalty on the I-T department and its officers. Resolution at CIT (Appeals) take about two years, 3-5 years at ITATs, 5-8 years at High Courts and about five years at the Supreme Court (SC). It is common knowledge now that tax dispute in India normally takes 15-20 years from the time an assessment is completed to the time the SC possibly takes a decision. In some instances, even the SC decision is not given effect to urgently, and obviously, CBDT doesn't seem to review or care!

The I-T department is the largest tax litigant in India. The 2018 Economic Survey states that, of the total number of direct tax cases pending, the department has initiated 88% of the litigation at ITATs and the SC, and 83% of the litigation pending at High Courts. The success rate of the taxman for both direct and indirect tax litigation at all levels is under 30%. The 2017 CAG report states that the I-T department loses 65% of its cases. Over a period of time, its success rate has only been declining. But our political leadership again has failed to protect taxpayers.

The CBDT, in July 2018, enhanced monetary limits for filing of appeals by the I-T department before the ITATs (`20 lakh), HCs (`50 lakh) and SC (`1 crore). These would prevent tax officers from routinely filing frivolous cases and enable a judicial focus on high-value litigations. Even while these limits are per se very low for a meaningful impact, the CBDT has to repeatedly urge its officers to withdraw all pending appeals before a certain period. Even the CBDT writ does not seem to work!

A perusal of all the above makes one come to the inescapable conclusion that NDA II was not successful in keeping its promise of ending tax terrorism. On the ground, not much impact has been felt even though processes and technology seem to have been improved. Tax disputes remain as high as before. When NDA II came to power, the amount of tax dispute in March 2014 was `4.10 lakh crore as per Receipt Budget 2015-16—it was up by 50% to `6.24 lakh crore in March 2018, as per Receipt Budget 2019-20.

Jaitley, in his 2016 Budget speech stated, "Litigation is a scourge for a tax-friendly regime and creates an environment of distrust in addition to increasing the compliance cost of the tax payers and administrative cost for the Government." He made many such statements, but seems to have promptly forgotten them.

The government has failed to protect citizens and business from a tax system that has run amok with a broken assessment system and a broken appeal system! No major country has both broken. Tax officials seem to think of everybody as evaders and themselves as vigilantes! We have filed returns in over 30 countries, but no country treats taxpayers as badly as India does. There can't be ease of doing business unless the taxation system is fair and effective. Several committees, from the Kelkar committee to the Shome committee, have suggested solutions, but these have been given scant regard. The government must decide on implementing the panels' suggestions and treat taxpayers fairly. The NDA thanks the tax payers in the budget—never the case with the UPA—but the rest of the treatment remains almost the same.

The PM is committed to improving Ease of Doing Business. But the most significant ease would come from fair, equitable tax assessment with no high-pitched demands and appeals decided in 3-4 years. We hope the PM and the new FM tackle the biggest impediment to Indian business becoming globally competitive, and India being respected globally for a fair tax system.

Link: Tax Justice Has Broken Down

TAX TERRORISM

TAX DISPUTE DATA SHOW THAT NDA II HAS FAILED TO TACKLE TAX TERRORISM, AND THE LEGACY PROBLEMS OF HIGH-PITCH DEMANDS & LITIGATION DELAYS CONTINUE

Tax justice has broken down

TV MOHANDAS PAI & S KRISHNAN

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Amounts under dispute as at the end of reporting year (₹ crore)

	Taxes on income and expenditure		Corporation tax		Taxes on income other than corp. tax	
	2017-18	2013-14	2017-18	2013-14	2017-18	2013-14
Over 1 year but < 2 years	3,13,387	2,35,482	2,19,739	96,978	93,648	1,38,504
Over 2 years but < 5 years	2,71,319	1,35,655	1,60,537	41,861	1,10,782	93,794
Total	6,23,539	4,10,523	3,99,188	1,50,802	2,24,351	2,59,721
Amounts not under dispute as at the end of reporting year (₹ crore)						
Total	1,08,751	65,196	69,480	41,211	39,271	23,985
Ratio of amounts under dispute and not under dispute	5.7	6.30	5.8	3.7	5.7	10.8

Source: Tax revenues raised but not realised (Principal Taxes), Annex-5, As at the end of Reporting Year 2017-18, Receipts Budget, 2019-20. Annex-11, As at the end of Reporting Year 2013-14, Receipts Budget, 2015-16

Reduce corporate tax to achieve $5 trillion economy

TV Mohandas Pai and S Krishnan

The Receipt Budget 2019-20 reveals that a small number of companies, 373, with profits before taxes (PBT) of `500 crore and above, contributed 52% of CT in FY18 and 16.35% of CT was contributed by 1,236 companies with PBT of `100-500 crore.

It is five years since the NDA began its first innings, and it's time to evaluate India's competitiveness on the direct tax front. Arun Jaitley, in his 2015 Budget speech, announced, "We are considered as having a high Corporate Tax (CT) regime but we do not get that tax due to excessive exemptions. I propose to reduce the rate of Corporate Tax from 30% to 25% over the next four years. This process of reduction has to be necessarily accompanied by rationalisation and removal of various kinds of tax exemptions and incentives for corporate taxpayers, which incidentally account for a large number of tax disputes."

He started the process of tax reduction in FY17, with a small reduction of 1% for companies whose turnover was less than `5 crore, and announcing a CT of 25% for new manufacturing companies who do not avail of any exemption. In his last 2018 Budget proposal, he extended the 25% rate reduction to MSME's with annual turnover up to `250 crore.

There was high expectation that the new FM, Nirmala Sitharaman, in her maiden budget, would fulfil the earlier promise of reducing CT to 25% for all companies by 2019. She said, in her maiden budget speech, "So far as CT is concerned, we continue with phased reduction in rates. Currently, the lower rate of 25% is only applicable to companies having annual turnover up to `250 crore. I propose to widen this to include all companies having annual turnover up to `400 crore. This will cover 99.3% of the companies. Now only 0.7% of companies will remain outside this rate". The FM forgot to mention that 0.7% of the companies in India contribute about 79% of the total CT.

The Receipt Budget 2019-20 reveals that a small number of companies, 373, with profits before taxes (PBT) of `500 crore and above, contributed 52% of CT in FY18 and 16.35% of CT was contributed by 1,236 companies with PBT of `100-500 crore. Two years after the CT reduction began, about 68.5% of the total CT was contributed by a miniscule 0.2% of all companies! What was promised by the FM in his 2015 budget speech remains unfulfilled.

The Effective Tax Rate (ETR) and the average statutory CT in FY18 is the highest in the past five years for all companies. The ETR is 29.49% for FY18, compared to 23.22% in FY14—an increase of 27%. This ETR increase has contributed `1.11 lakh crore out of `5.24 lakh core collected as CT. The Receipt Budget 2019-20 states that the impact of 2017 Budget proposal of 25% CT for companies having turnover up to `50 crore is minimal. The NDA government has thus phased out profit linked deductions without proportionately reducing the CT. Obviously, FM Jaitley has not kept his promise.

Nature of incentive (₹ cr)	Revenue impact 2017-18	Projected revenue impact (2018-19)
Accelerated Depreciation (section 32)	58,326.25	67,758.18
Deduction of export profits of units located in SEZs (section 10A and 10AA)	20,917.63	24,300.22
Deduction of profits of undertakings engaged in generation, transmission and distribution of power (section 80-IA)	13,156.97	15,284.58
Deduction of profits of undertakings engaged in development of infrastructure facilities (section 80-IA)	6,841.97	7,948.38
Deduction/weighted deduction for expenditure on scientific research (section 35 (1), (2AA) &(2AB))	6,832.02	7,936.82
Deduction in respect of specified business (section 35AD)	1,780.70	2,068.66
Total	**1,07,855.54**	**1,25,296.84**
Total tax incentives	**1,20,069.67**	**1,39,486.12**
Net Additional Tax due to MAT	26,427.17	30,700.70
Net Revenue Foregone	**93,642.50**	**1,08,785.41**
Share of top 6 tax incentives to total of all tax incentives	**90%**	**90%**

Source: Table 5, page 31, Receipts Budget, 2019-20

When the FM announced a rate reduction to 25% over four years, it was expected that this rate reduction would benefit all the companies. By providing CT reduction to MSME's, others have not benefited. Instead, they have been forced to pay more tax due to withdrawal of tax incentives and imposition of 2% additional surcharge from FY16. The ETR for large companies has consequently increased from 20.68% in FY14 to 26.3% in FY18, a 27% increase.

Large companies in the services sector are the biggest employers in India. They provide stable jobs at good remuneration. However, the services sector, which is more job oriented, has a 2.7% higher ETR at 30.55% in FY18 compared to 27.83% in the manufacturing sector, which adopts capital intensive automation and enjoys tax incentives. India incentivises automation and taxes job creation more!

A reduction in the CT of all companies to 25%, and not just for MSMEs, will enable large companies to compete globally, increase their growth leading to higher employment, better quality jobs, and reduce the high cost of capital in India. This will support India becoming a $5 trillion economy.

The accompanying graphic provides the revenue impact of top six incentives for CT payers during FY18 and FY19. Budget 2016 reduced the maximum depreciation rate to 40%, with effect from FY18, and removed other deductions. A reduction in the maximum depreciation rates to 25%, and the general rate to 10% would enable the government to reduce the CT for large companies by about 2%. A reduction in the CT will reduce the cost of credit from the banking system over time and make the job-intensive services sector more competitive. A 2% CT reduction will enable banks to write back deferred taxes up to `10,000 crore and corporates will be able to write back about `25,000 crore. By lowering the CT, the labour intensive industries will have more cash to grow faster and create more jobs, which is India's top priority.

Jaitley had also announced, in Budget 2015, his "vision of putting in place a direct tax regime which is internationally competitive on rates, is without exemptions, incentivises savings, and does not realise tax from intermediaries."

A study on the CT around the world in CY 2018 reveals that the worldwide average statutory CT to be 23.03%, measured across 208 tax jurisdictions. The average statutory CT is 21.86% among EU countries, 23.93% in OECD countries and 27.63% in the G7. The US has a combined statutory rate of 25.84%. The majority of the 208 separate jurisdictions surveyed have CT below 25% and 103 have rates between 20% and 30%. This study was conducted by Tax Foundation, a tax policy non-profit organisation based in the US.

India's average statutory CT at 34.4% in FY18 is higher by more than 10% compared to the worldwide average statutory CT. Instead of India being internationally competitive in tax rates, it has the highest CT among the large economies in CY18. It is in the ninth spot among the 20 countries with the highest CT in the world. This high CT in India is negatively impacting the competitiveness of Indian multinational companies, and India as a destination for investment. When overseas investors come to India with a much lower cost of capital, Indian entrepreneurs cannot compete with a much higher cost.

At the end of five years of NDA government, the CT reduction is not provided to all companies but only to MSMEs. Tax collection has increased hugely by reduction of depreciation rates and withdrawal of corporation taxbreaks. India has the highest CT among large economies, making its direct tax regime most uncompetitive internationally. The quantum of tax litigation in India has gone up considerably at all levels too. While Our FMs have been lofty in making statements, they have not kept their promise.

It is very important for the present FM to first reduce the CT to 25% for all companies, incentivise labour-oriented service industries in India and keep the promise made to its citizens which will enable India to move to a $5 trillion economy.

Link: Reduce corporate tax to achieve $ 5 trillion economy

Section 56: 2(viib) or not 2(viib)

Siddarth M Pai

How the legislative intent of the angel tax is being subverted and used indiscriminately

To paraphrase Hamlet,
Section 56: 2(viib) or not 2(viib), that is the question:
Whether 'tis nobler in the mind to suffer
The slings and arrows of outrageous fortune,
Or to take arms against a sea of troubles

This seems to be the question plaguing entrepreneurs all across India as many see looming tax bills of 30% of the amount of capital they've raised being levied against them. But to understand why the government seeks to tax capital receipts as revenue, we need to explore the context and history behind this section.

In 2012, during the UPA government's tenure, India witnessed the introduction of the "angel tax" and Section 68 through the following words of Shri Pranab Mukherjee's in his last budget to parliament:

> "*I propose a series of measures to deter the generation and use of unaccounted money. To this end, I propose:*
> *Increasing the onus of proof on closely held companies for funds received from shareholders as well as taxing share premium in excess of fair market value*."

The reason for this harsh insertion was due to the Enforcement Directorate uncovering several transactions involving Jaganmohan Reddy wherein people had "*paid bribe to Reddy in the form of investments at exorbitant premiums in his various companies to the tune of Rs 779.50 crore apart from making payment of Rs 57 crore to him in the guise of secondary purchase of shares and donation of Rs 7 crore to YSR Foundation*" (PTI link).

To counter this, the 2012 Finance Bill had tabled exclusive measures to "prevent generation and circulation of unaccounted money". This saw the introduction of a slew of measures such as sections 56(2)(viib) – taxation of premium in excess of fair market value, section 68 - unaccounted cash credits, section 69 – unexplained investments, etc. The budget memo accompanying the insertion of these sections also states, "*the pernicious practice of conversion of **unaccounted money** through masquerade of investment in the share capital of a company needs to be prevented*"

But is the legislative intent to tax unaccounted money received as premium or any and all share premium received by startups?

A legal test to analyse this comes from Heydon's Rule (1584), which requires the consideration of four matters in constructing any piece of legislation:

- What was the law before this enactment?
- What was the mischief of defect for which the law did not provide?
- What was the remedy that the enactment provided?
- What was the reason for this remedy?

The 2012 budget memo titled" MEASURES TO PREVENT GENERATION AND CIRCULATION OF UNACCOUNTED MONEY" actually provides answers to all these questions.

1. What was the law before this enactment?
    - There was no single law before the enactment of these measures and, to cite the memo, "*Certain judicial pronouncements have created doubts about the onus of proof and the requirements of this section,* ***particularly, in cases where the sum which is credited as share capital, share premium etc."***
2. What was the mischief or defect for which the law did not provide?
    - The mischief for which the law didn't provide was "*the pernicious practice of* ***conversion of unaccounted money through masquerade of investment*** *in the share capital of a company"*
3. What was the remedy that the enactment provided?
    - The remedy the enactment provided was the insertion of section 56(2)(viib), 68, etc to "*deter the generation and use of* ***unaccounted money"***
4. What was the reason for this remedy?
    - The reason for this remedy was to create legislation and measures to "*prevent the generation and circulation of* ***unaccounted money***"

Thus, this begs the question: why is a law meant to prevent the conversion of unaccounted money being used against all startups raising capital from known sources through bank transfers? **It is clear that the legislative intent is to prevent unaccounted funds from being laundered and not to tax any and all share premium as income.**

Yet this intent is being subverted and used as a weapon against all startups indiscriminately purely on the basis of a high share premium. A high share premium is not the cause of a high valuation but the outcome of valid business decisions regarding the face value and capital base of a company. Furthermore, a relative high share premium paid through accounted funds via bank transfers and proper compliance filings forms the antithesis of unaccounted funds that is at the heart of this legislation. This is best shown by the following example:
Startup A chooses to begin its journey with an initial capital of Rs 1 lakh. The balance sheet after incorporation would be:

Particulars	**Amount (Rs)**	**Particulars**	**Amount (Rs)**
Share Capital	1,00,000	Fixed Assets	60,000
		Cash	40,000
Total	**1,00,000**	**Total**	**1,00,000**

Figure 2 – Financials post incorporation

The Founders bootstrap the business through personal loans or further equity until they can attract angel funding. They choose to fund the initial operations with a loan of Rs 2.25 lakhs. Their financials before any funding round would be:

Particulars	**Amount (Rs)**	**Particulars**	**Amount (Rs)**
Share Capital	1,00,000	Fixed Assets	60,000
Shares	1,00,000	Cash	15,000
Losses	(2,50,000)		
Loans	2,25,000		
Total	**75,000**	**Total**	**75,000**

Figure 3 – Financials before funding

Startup A manages to attract angel funding at Rs 1 Crore at a post-money enterprise valuation of Rs 10Cr (arrived at via Discounted Cash Flow) from various angel investors

- Share base: 10,000 shares
- Face Value: Rs 10 each
- Post-Money Enterprise Valuation: Rs 10 Crore
- Share Issue Price: 10 Crore/10,000 shares = Rs 10,000
- Share Premium (Issue Price – Face Value) – Rs 9,990

Whereas the book value prior to funding would be determined as follows:

$$\frac{\text{Assets – Liabilities}}{\text{Number of shares issued}}$$

$$= \frac{75{,}000 - 2{,}25{,}000}{10{,}000}$$

= (Rs 15/ share)

Post the Rs 1 crore round of funding, the financials would resemble the following:

Particulars	**Amount (Rs)**	**Particulars**	**Amount (Rs)**
Share Capital	1,01,00,000	Fixed Assets	60,000
Shares	1,10,000	Cash	1,00,15,000
Share Premium	99,90,000		
Losses	(2,50,000)		
Loans	2,25,000		
Total	**1,00,75,000**	**Total**	**1,00,75,000**

Figure 4 – Financials Post Funding

Thus, Startup A, with a Net Asset Value of negative Rs 15, raised capital at a share premium of Rs 9,990, a difference of 666x! This shows how a high share premium is the consequence of the mathematics underpinning valuation, not a cause of high valuations.

In the zeal to snuff out black money, caution must be exercised so that genuine transactions don't end up as collateral damage. After all, should the wicked consume the righteous?

Link: Start-up funding: High share premium is consequence of mathematics underpinning valuation

START-UP FUNDING

HIGH SHARE PREMIUM IS THE CONSEQUENCE OF THE MATHEMATICS UNDERPINNING VALUATION, NOT A CAUSE OF HIGH VALUATIONS

Section 56: 2(viib) or not 2(viib)

SIDDARTH PAI

Founding partner at 3one4 Capital

TO PARAPHRASE HAMLET, section 56: 2(viib) or not 2(viib), that is the question:

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The slings and arrows of outrageous fortune,
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This seems to be the question plaguing entrepreneurs all across India as many see looming tax bills of 30% of the amount of capital they've raised being levied against them. But to understand why the government seeks to tax capital receipts as revenue, we need to explore the context and history behind this section.

In 2012, during the UPA government's tenure, India witnessed the introduction of the "angel tax" and Section 68 through the following words of Pranab Mukherjee's in his last budget to Parliament, "I propose a series of measures to deter the generation and use of unaccounted money. To this end, I propose: Increasing the onus of proof on closely held companies for funds received from shareholders as well as taxing share premium in excess of fair market value".

The reason for this harsh insertion was due to the Enforcement Directorate (ED) uncovering several transactions involving Jaganmohan Reddy wherein people had "paid bribe to Reddy in the form of investments at exorbitant premiums in his various companies to the tune of ₹779.50 crore apart from making payment of ₹57 crore to him in the guise of secondary purchases of shares and donations of ₹7 crore to YSR Foundation" (*bit.ly/2RxuZ9w*).

To counter this, the 2012 Finance Bill had tabled exclusive measures to "prevent generation and circulation of unaccounted money". This saw the introduction of a slew of measures such as sections 56(2)(viib), the taxation of premium in excess of fair market value, sections 68 and 69 for unaccounted cash credits and unexplained investments respectively, etc. The budget memo accompanying the insertion of these sections also states, "the pernicious practice of conversion of unaccounted money through masquerade of investment in the share capital of a company needs to be prevented".

But is the legislative intent to tax unaccounted money received as premium or any and all share premium received by start-ups?

A legal test to analyse this comes from Heydon's Rule (1584), which requires the consideration of four matters in constructing any piece of legislation and the the 2012 budget memo, *Measures to prevent generation and circulation of unaccounted money*, actually provides answers to all these questions:

■ What was the law before this enactment?

There was no single law before the enactment of these measures and, to cite the memo, "Certain judicial pronouncements have created doubts about the onus of proof and the requirements of this section, particularly in cases where the sum which is credited as share capital, share premium, etc".

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The remedy the enactment provided was the insertion of section 56(2)(viib), 68, etc, to "deter the generation and use of unaccounted money".

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The reason for this remedy was to create legislation and measures to "prevent the generation and circulation of unaccounted money".

Thus, this begs the question: why is a law meant to prevent the conversion of unaccounted money being used against all start-ups raising capital from known sources through bank transfers? It is clear that the legislative intent is to prevent unaccounted funds from being laundered and not to tax any and all share premium as income.

Yet, this intent is being subverted and used as a weapon against all start-ups indiscriminately, purely on the basis of a high share premium. A high share premium is not the cause of a high valuation but the outcome of valid business decisions regarding the face value and capital base of a company. Furthermore, a relatively high share premium paid through accounted funds via bank transfers and proper compliance filings forms the antithesis of unaccounted funds that is at the heart of this legislation. This is best shown by the following example:

Start-up A chooses to begin its journey with an initial capital of ₹1 lakh. The balance sheet after incorporation is in the attached graphic. Its financials before any funding round are also described in the attached graphic. Start-up A manages to attract angel funding at ₹1 crore at a post-money enterprise valuation of ₹10 crore (arrived at via discounted cash flows) from various angel investors.

■ Share base: 10,000 shares
■ Face value: ₹10 each
■ Post-money enterprise valuation: ₹10 Crore
■ Share issue price: 10 crore/10,000 shares = ₹10,000
■ Share premium: (issue price – face value) = ₹9,990

The book value prior to funding would be determined as per the steps shown in the attached graphic and, post the ₹1 crore round of funding, the financials would resemble the values as also shown in the attached graphic.

Thus, start-up A, with a net asset value of negative ₹15, raised capital at a share premium of ₹9,990, a difference of 666 times! This shows how a high share premium is the consequence of the mathematics underpinning valuation, not a cause of high valuations. In the zeal to snuff out black money, caution must be exercised so that genuine transactions don't end up as collateral damage. After all, should the wicked consume the righteous?

Financials post incorporation

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Total	1,00,000	Total	1,00,000

Financials before funding

Particulars	Amt (₹)	Particulars	Amt (₹)
Share capital	1,00,000	Fixed assets	60,000
Shares	1,00,000	Cash	15,000
Losses	(2,50,000)		
Loans	2,25,000		
Total	75,000	Total	75,000

$$\frac{\text{Assets - Liabilities}}{\text{No. of shares issued}} = \frac{75,000 - 2,25,000}{10,000} = (₹15/\text{share})$$

Financials post funding

Particulars	Amt (₹)	Particulars	Amt (₹)
Share capital	1,01,00,000	Fixed assets	60,000
Shares	1,10,000	Cash	1,00,15,000
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Will the wicked consume the Righteous?

How start-ups are ending up as collateral damage in a war against black money

TV Mohandas Pai & Siddarth M Pai

In India's quest to become a 10 Trillion Dollar economy by 2030, start-ups play a pivotal role in job creation, value accretion and innovation. India is the third largest start-up ecosystem in the world with more than 50,000 start-ups launched in India creating 130 Billion Dollars of value and raising 38.5 Billion dollars between January 2014 to September 2018.

Yet the tragedy of our system is that out of 26 unicorns in India and of the 30 soonicorns (potential unicorns), a third of them have their headquarters outside India; and out of all the investments into these companies, only 10% comes from domestic capital. India runs the risk of becoming a digital colony where the value generation lies within the country but the shareholder and value accretion is benefiting foreign nationals.

Whilst the present government has done remarkable work in creating an entrepreneurial milieu in the country via the Startup India scheme, Atal Innovation Mission and other structures, there still exists a lightning rod of discontent and harassment for start-ups: Section 56(2)(viib) of the Indian Income Tax Act, 1961.

Section 56(2)(viib), also called the "Angel tax", is a tax levied by the government on any private company that raises capital above its fair market value. The difference between this FMV and the price at which the shares are issued are taxed in their hands at the maximum marginal rate. *The concept of taxing capital receipts and investments as income is unique in the principle of taxation and exists only in India in this clause.* Though the law offers the choice of valuation to the assessee company, what we're witnessing is the Assessing Officers disregarding this freedom and instead of taking it upon themselves to value the Company, like an investor would (without putting the requisite capital behind this themselves). These officers ignore the valuation report prepared by a Merchant Banker of Chartered Accountant in favour of the current net-worth of the Company. Not even listed companies trade at their book values since this value is a historic one, whereas the valuation of the company is supposed to take into consideration future growth and earning potential as well.

Futhermore, to establish the creditworthiness of the investor (Section 68), the Assessing Officers are demanding the bank statements, Income Tax Returns and financial statements of all the investors from these Companies. Given the sensitive nature of these documents, not investor feels comfortable sharing them with their investee company. In spite of the tax department having these documents on record, which can be accessed by them via the Investor's PAN, these heavy demands are made of the Companies with a very narrow timeframe to obtain these documents. *If this continues to be the state of affairs, the angel funding ecosystem, which has seen a decline of 48.5%, from 653 investors in 2016 to 343 in 2018, will ultimately dry up.* Angel funding is the highest risk strata of funding since these companies are just starting off or just developing their product or go-to-market strategy. While the UK, Singapore, the US etc have schemes and tax breaks to incentivise angel investors, India is taking a regressive step to dissuade angels from investing in these companies. Ironically, these measures of sections 56(2)(viib) and 68 only apply to domestic investors and not to non-resident investors. This discrimination against domestic investors is one of the reasons why domestic capital forms such a small part of the capital pool investing into startups in India. This aggravation faced by startups and investors runs directly counter to the promises made by the government of encouraging entrepreneurship and increasing the ease of doing business. The removal or change of this draconian measure has been a constant demand of the startup ecosystem since the government took over, yet no measures have been taken. *Though this angel tax section was not a product of the current government, they are facing the blame for the consequences of this and the effect it has on entrepreneur morale.* The current set-up of receiving IMB (Inter-Ministerial Board) approval, the only succour from these sections, only applies to those companies incorporated after April 1st, 2016 whereas the majority of these companies and cases related to prior years. Drastic change is essential for these startups to thrive. Some entrepreneurs, who are facing this the second time around, are so fed up that they want to shut down the company, relocate to a more favourable jurisdiction and then open a subsidiary in India, thus shifting the value creation cycle outside India.

The 2012 budget speech prefaced the introduction of these measures by stating that they were to curb the laundering of black money through private limited companies. But it begs the questions as to why start-ups, who raise money through bank transfers and not cash, file all the forms with the Registrar of Companies and the RBI for their capital raises, obtain a genuine valuation report and follow the law to the letter and spirit are being harangued in this fashion. Laundering money through normal banking channels, with a visible paper trail that anyone can access via the MCA (Ministry of Corporate Affairs) records, runs counter-intuitive to the clandestine and trail-less nature of laundering money.

In the words of the noted jurist, William Blackstone, “It is better that ten guilty persons escape than that one innocent suffer”. Yet the current system seems fine to invert that statement and allow ten innocents to suffer to in order to catch a single guilty culprit. If the aim is to curb the laundering of funds via private companies, then better filters are required. Companies who have not filed the forms, received money in cash or cannot provide the PAN of their investors should only be targeted. The Tax Department should leverage big-data analytics to verify if the investors in start-ups have the financial ability and tax-paid money to make such investments. Passing the onus onto the Company to provide this information and to do the Department’s job is ludicrous. Valuation is both an art and a science. Every book about valuation speaks about how different valuers can arrive at different values using different techniques. It is not the job of the tax department to dictate how a tax-paying citizen should invest his money or what value he sees in a startup. Valuing a company without making the investment is taking armchair investing to a different level.

With the upcoming election and the discontent around this measure reaching a fevered pitch, it is imperative that Prime Minister Modi himself intervenes and sees that law-abiding companies are not eviscerated by such arbitrary action.
After all, a tax is not the best form of defence.

Link: Will the wicked consume the righteous?

This isn’t an “Angel Tax”, it’s an Indian Tax

Siddarth M Pai

How the “Angel Tax” is hastening India’s descent into a Digital Colony

The euphemism of “angel tax” for section 56(2)(viib) makes this section seem innocuous – an isolated phenomenon that affects only a small section of society. But make no mistake – section 56(2)(viib) is not an “angel tax”, it’s an “Indian Tax”. It seeks to tax any investment received from an Indian startup from any Indian resident. It does not apply only to “angel investors”, usually individuals who are early investors into Indian startups, but even applies to investments from listed companies, trusts, mutual funds and even institutions like LIC! All their investments into startups are liable to this pernicious piece of legislation introduced in 2012 by the UPA government.

India is at risk of becoming a digital colony. Since liberalisation, India has seen five main waves of growth. It started with the wave of technology companies from the 1990s, a cadre of sophisticated companies who have become global leaders in their domain. Out of the top 10 IT services companies in the world by market value, 5 of them are Indian; out of the top 5, 3 of them are India. Indian IT exports total 126 billion dollars per annum as of March 2018. India has 4.5 million people in IT, out of which 3 million work in the IT services sector. Our next wave was telecom – a bitter fought struggle which has seen the rise of Airtel and now Jio as the largest players. Next, India witnessed the growth of pharma companies, who have carved a niche for them worldwide. India’s next wave of infrastructure players have contributed to the vast urbanisation of India, with the crony capitalists amongst them being dealt with by the Insolvency code and the NCLT.

The latest wave India is in the midst of is the digital wave, which is seeing Indian entrepreneurs establish companies outside India, raise capital from majorly foreign sources and have all our data reside outside India. Companies like Google, Facebook, Amazon, etc have all our data hosted on servers all across the world except in India. RBI’s decent diktat to payment companies to host all the payment data of Indians in India is a step in the right direction as it offers a legal remedy to all Indians in case their data is misused. An Indian national cannot go to a US court for any misuse of their personal data as we would be considered as a non-resident alien in their legal system, subject to limited rights. By having our data reside here, Indians can at least seek recourse from our judicial system in case of any abuse. This is why the data privacy bill is essential to all Indians and the honourable Supreme Court was right in stating that the right to privacy is a fundamental right.

But the “angel tax”, rather, “Indian tax”, actively discriminates against Indian investors who wish to participate in this digital wave from investing into Indian startups. By virtue of this and the lack of incentives, only 10% of the 38.5 billion $ raised by Indian startups are from domestic sources. A large number of Indian unicorns have foreign investors as their major shareholders, with some even holding their board meetings in foreign nations!

The Finance Minister Arun Jaitley has gone on record to state - "*Entrepreneurs need freedom from the state, the sector should be less regulated. India's IT sector grew because we had no laws restraining them*." In areas of corporate compliance, capital raises, FDI, etc, the current government has kept this promise. The single Achilles heel in Startup India has been the taxation angle, which places layers and layers of red tape for Indian Startups and investors.

The only tax incentive for Indian investors if section 54GB, which places restrictions on ownership and investment (mandatorily 50% for Rs 50 lakhs, which renders the section unfeasible), type of eligible gains (proceeds from the sale of house property), the type of instrument (only equity shares), use of funds (categorically states that it can't be used to purchase computers of software, which excludes all tech startups), amongst others.

In spite of this, India is the third largest startup ecosystem in the world with over 39,000 active startups who have created over 130 billion dollars of value with 26 unicorns. Indian entrepreneurs have the unique ability to thrive in spite of our tax policies, not because of them.

But after close to 72 years of Independence, Indians should stand up and question our tax department as to why they seek to discriminate against Indians for supporting Indian startups. Indian capital should be placed on par with foreign investors, not handicapped.

Our tax department needs to shed this colonial hangover of seeing all Indian investors as crooks and instead learn to embrace them as active participants in the Indian startup ecosystem. In one of his speeches before the launch of Startup India on January 16th, 2016, Prime Minister Modi said, "*Hindustan mein koi aisa zila na ho, aisa block na ho jahan koi startup na shuru ho. Start up India, Stand Up India*"

What can Indian startups do when the singular blocker to is India's discriminatory tax policies?

Link: This isn't an Angel Tax, it's an Indian Tax

How the Angel Tax is accelerating India's descent into a Digital Colony

Siddarth M Pai

Mera juta hai jaapaani, ye patalun englistaani

Sar pe laal topi rusi, phir bhi dil hai hindustaani

Magar poora capital *hai americani*

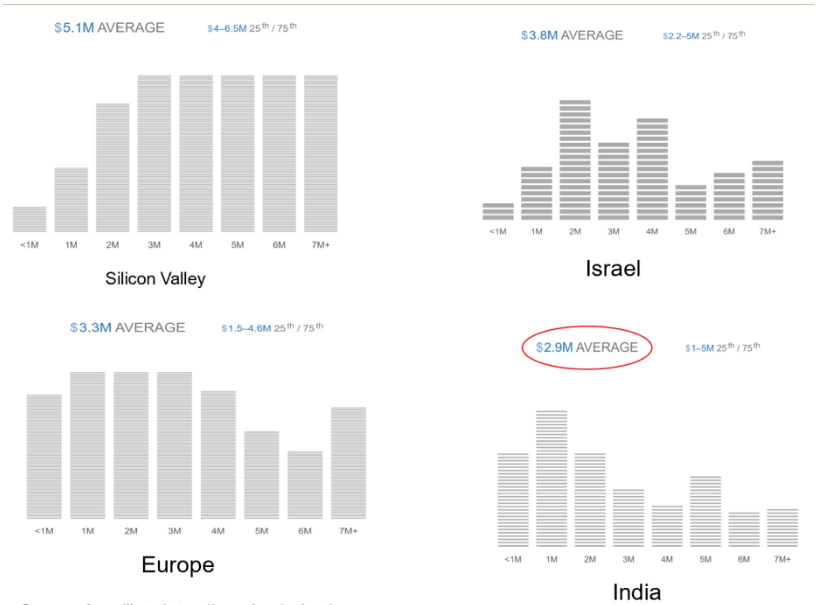
This is the plight of the Indian entrepreneur – his heart is Indian, but his business and capital are foreign. India has traditionally been a capital-deficient nation. Our cost of capital is amongst the highest in the world for economies of our size, equities form a meagre 4.6% of household assets, and our markets quake every time foreign investors (FIIs) decide to take money out. Even our Prime Minister, on his various foreign trips, exhorts our diaspora to invest into India - "*To me, FDI means First Develop India through Foreign Direct Investment, the norms of which have been fully liberalised for non-resident Indians and persons of Indian origin*". But though FDI policy has been liberalised for foreign investors and NRIs, India counterintuitively disincentivises Indian investors from investing.

Amongst the entire world, India stands alone in discriminating against its citizens from investing into Indian companies via measures like the "Angel Tax" (section 56(2)(viib)). This section, introduced by the UPA government in 2012, taxes the capital receipts of private companies as income which is above the "fair market value" of the same from only Indian investors. This section has been the bane of Indian entrepreneurs as they have seen their valuation thrashed by the Income Tax Department and have seen levies of 30% on the entire capital raised from domestic sources!

Attacking share premium and valuations of companies as a fight against black money are indulging in shadowboxing – a large amount of activity with little achievement. Even the assumptions underpinning this section are tenuous at best.

Indian companies command excessive valuations

The claim that Indian startups have inflated valuations falls flat the moment you compare their valuations to the worldwide average. Amongst all the start-up ecosystem in the world (US, China, Europe, Israel), Indian startups command the lowest valuations for early-stage funding. This is in part due to the low costs associated with talent acquisition and development, but it dismantles this prevailing notion that the valuations commanded by Indian startups are excessive and need to be taxed.



Source: Angellist - https://angel.co/valuations

Indian startups have the lowest valuations

High Share Premium = Black Money

Share premium is the outcome of the mathematics underpinning valuation, not the cause of high valuations. The issue price of any security if a function of the enterprise valuation ascribed to it by investors and the number of securities that the company has issued prior to this round of funding

$$\text{Issue Price} = \frac{\text{Enterprise Valuation}}{\text{No of shares issued}}$$

The issue price can be decomposed into two constituents: face value + share premium. This relationship can be explored through an example:

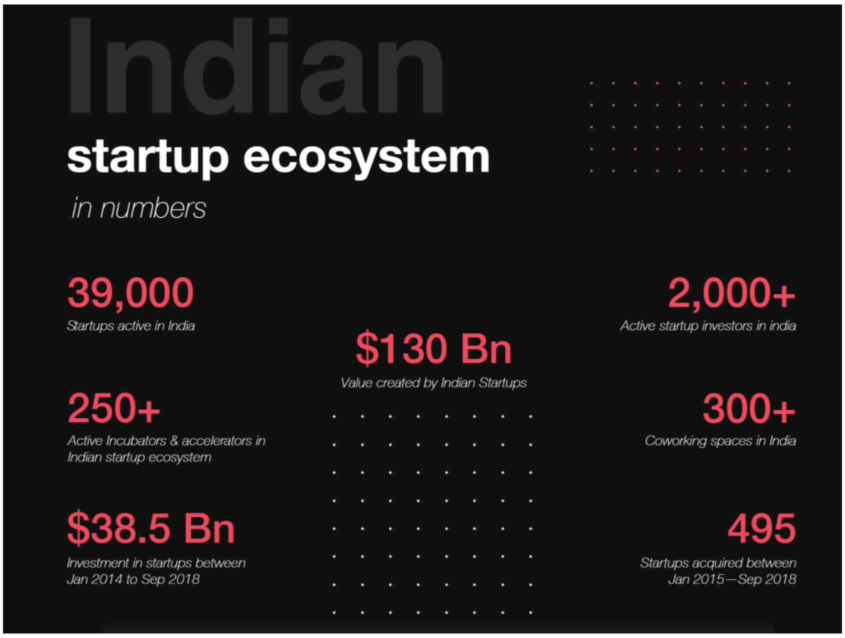
- Enterprise valuation: Rs 10 Crore
- No of shares issued: 10,000 shares
- Face Value: Rs 10

Thus, the Issue Price would be Rs 10Crore/10,000 shares = Rs 10,000
Since the Face Value is Rs 10, the share premium ends up being Rs 9,900! (Rs 10,000 – Rs 10)

This 9,900 by itself is meaningless as it's the simple outcome of the maths underpinning valuation and in no way can reflect the true value of the company, the existence of black money, or any of the other stated reasons for this existing in the statute books.

Consequences of the Angel Tax:

Inc42, in their report titled "State of the Indian Startup ecosystem – 2018", have illustrated the value created by Indian startups in India.



But what's alarming is that out of the 38.5 Billion dollars of investments into Indian startups, only 10% is from Indian sources! This funding is also concentrated in the early stage of the startup's lifecycle, when the risks associated with the investment are the highest. The source of these funds is HNIs, other entrepreneurs, CXOs, family offices, friends and family. So not only do they have to contend with a heightened risk profile, illiquid securities, but they also have a tax regime that's scripted specifically against them.

But it looks like the angel tax is the straw that broke the camel's back. Number of Unique Domestic Investors down by 48% from 2015

Unique investor participation in funding

	2014	2015	2016	2017	2018
Angel Investors	106	506	653	512	343
Angel Networks & Platforms	8	24	27	27	17
Corporates	50	132	207	198	261
Venture Capital	70	226	249	298	228

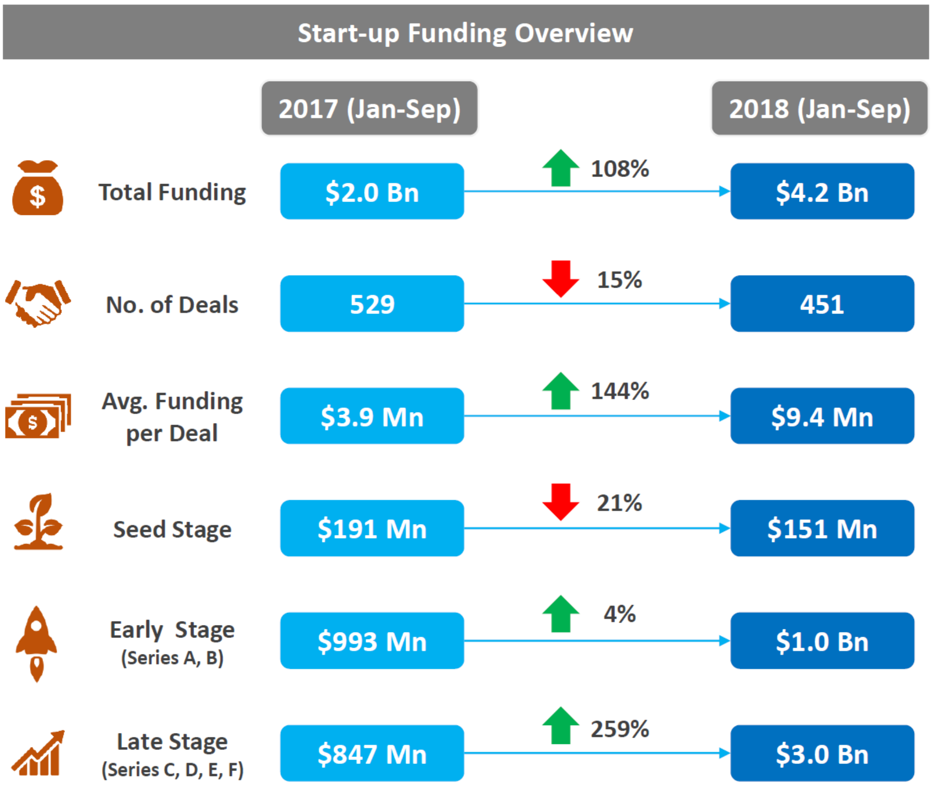
Source: Inc 42 – State of the Indian Startup Ecosystem 2018

Number of Early Stage Rounds is Down 28.5% from 2015

INVESTMENTS IN START-UPS BY ROUND						
Year	***Seed***	***Series A***	***Series B***	***Series C***	***Series D***	***Series E+***
2014	91	145	56	28	11	10
2015	208	257	93	41	12	11
2016	198	186	102	45	20	11
2017	174	154	101	30	21	15
2018	148	137	83	62	24	15

Source: Venture Intelligence

Early Investments drop while funding across other stages rise



Nasscom report – Indian Startup ecosystem Approaching Escape Velocity – Edition 2018

Impediments instead of Incentives

Most Indian investors have resigned themselves to their fate that there will be no incentivises to continue making angel investments. But several other countries around the world give credits and tax breaks to their angel investors through a variety of schemes:

- UK - Seed Enterprise Investment Scheme (SEIS)
- US – Section 1202
- Singapore – Angel Investment Tax Deduction Scheme (AITD Scheme)

Instead, all India has given its angels is Section 54GB of the Income Tax Act, 1961, which gives a tax break of Rs 50 lakhs for angel investments, with the following conditions:

- Restriction on the type of gains eligible
    - Only from the sale of house property or land
- Restrictions on the companies the money can be invested into
    - Startups incorporated after April 1st, 2016 who have received IMB certification (success rate of 1%)
- Restrictions on the type of securities issuable by the company
    - Only equity shares, not preference shares
- Restrictions on ownership
    - 50% for 50 lakhs, which no founder will ever agree to
- Restrictions on use of funds
    - Cannot be used to buy computers or software, hence every tech startup is excluded from this
- Restriction on exits
    - Any exit needs to be only after 5 years

Descent into a Digital Colony

Out of 30 Indian unicorns (companies valued above 1 billion dollars) and 26 soonicorns (companies with the potential to become unicorns), a third of them are headquartered overseas. With only 10% of their capital coming from domestic sources, the hassle of dealing with arbitrary tax terrorism in the form of the "angel tax" for such capital, entrepreneurs are wondering why they should remain in India when its far easier to have a US or Singapore entity with an Indian subsidiary (Flipkart did this and they're the most successful Indian startup to date!). Lip service such as Section 54GB are paper-tigers – full of sound and fury, but signifying nothing.

In one of his speeches before the launch of Startup India on January 16th, 2016, Modi said, "*Hindustan mein koi aisa zila na ho, aisa block na ho jahan koi startup na shuru ho. Start up India, Stand Up India*"

How what will the government due when the major impediment is of their own design?
India shouldn't have a case where Yeh jo desh hai mera, (swa)desh hai tera

Link: How angel tax is accelerating India's desent

Angel Tax isn't dead, it's deferred

Siddarth M Pai

Never has a tax displayed the flagrant disconnect between the bureaucracy and business like the "Angel Tax". In the "Measures to boost the Indian Economy" by the honourable Finance Minister, "Angel Tax" found an explicit mention – causing entrepreneurs to rejoice that this ordeal is over. But the devil lies in the details and this isn't dead – it's simply deferred.

Angel Tax, or section 56(2)(viib) of the Income Tax Act, 1961 was an insertion by the then UPA regime in 2012 as a means of checking the circulation of unaccounted funds through investments into private companies. It sought to attack "high share premium" – a supposed smoking gun of money laundering; instead, it turned out to be a red herring. A high share premium is the consequence of the mathematics underpinning valuation. Simple, legitimate corporate actions like having a small initial capital base and having a low face value (both mainstays of any technology startup) can translate into high share premiums. It is no more an indication of money laundering than having high-speed internet is an indication of online piracy.

The reason for this link between high share premium and money laundering arose from details uncovered by the Enforcement Directorate against Jaganmohan Reddy, where it was discovered that people had "*paid bribe to Reddy in the form of investments at exorbitant premiums in his various companies to the tune of Rs 779.50 crore apart from making payment of Rs 57 crore to him in the guise of secondary purchase of shares and donation of Rs 7 crore to YSR Foundation*". It was from here that the indelible link between share premium and unaccounted money was cemented in the minds of the tax officers.

The unintended consequence of this 2012 legislation was that it became a tool of harassment of startups in the hands of the taxmen. Indian startups raise between $12-14 billion of capital every year, with only under 10% of it coming from domestic sources. The bulk of domestic funding comes at the "angel" or "seed" stage – where the risks are the highest. All of them are valued by investors based on their potential and projections – not their present. Due to the factors mentioned above, all these securities were issued at a premium. It is this premium – this mathematical outcome that the taxmen attacked with vigour, raising demands of 30% of the share premium raised by the startups. It's no secret that these startups were easy pickings for the taxmen who were under pressure to meet their collection targets.

Worse off, it targets the money from Indian investors alone – no other country in the world has so actively discriminated against its own citizens in their own country. Not even the British would have inserted such a provision in the pre-independence era.

Over time, with the concerted effort of the media, entrepreneurs, business leaders, DPIIT and the politicians, the tax department drip-fed circulars to address parts of this issue – tilting at windmills instead of tackling the bull by the horns. But in February 2019, there was finally a breakthrough wherein this scourge of "Angel Tax" could finally be put to rest. The circular stated that all startups would be exempt from Angel Tax provided that they don't make any investments into a negative list for seven years from the date of issuing shares at a premium.

It is within this list that the Achilles heel of the Angel Tax exemption lies.

The negative list includes land, building, motor vehicle, aircraft, yacht, jewellery held by then, other than in the ordinary course of business. All reasonable asks as those are assets that do not contribute to general business and if it does, it's permitted. But it's pertinent to note that this carve-out in the ordinary course of business doesn't apply to 3 areas: loans and advances, shares and securities and capital contributions – and therein, as the bard says, lies the rub.

1. Loans and advances
   Loans and advances are such an integral part of a business that the format of financial statements mandated by the Company's Act gives detailed instructions on its presentation in a balance sheet. Some of the constituents include security deposits like rental deposits, down-payment on assets, advances to vendors, salary advances, loans to employees for purchasing ESOPs, salary advances and even advance tax.
   None of these by themselves are indicative of money laundering and all these are legal under all laws except the "Angel Tax" exemption. What's more surprising is that **discharging one's advance tax liabilities can potentially deny the startup its "Angel Tax" exemption**! A more ironic example of cutting the nose to spite the face is yet to be found.

2. Investments in shares, securities or making capital contribution:
   On the face of it, one can question why a startup would need to deal with shares and securities at such an early stage – a reasonable ask since the money raised can be invested into other entities, thus perpetuating the laundering of cash. But what the authorities fail to realise is that this hampers business productivity since it effectively bans all joint ventures, subsidiaries, stock mergers and acquisitions and treasury management! No longer can a company expand by setting up subsidiaries in other geographies or joint-ventures with other businesses. Stock M&A, which forms the bulk of consolidation in various sectors, is effectively killed since this would transgress the exemption. Treasury management, wherein companies park excess funds in short-term money-market listed instruments regulated by SEBI is now taboo.

The most pernicious part of this list is that it this moratorium should continue for seven years since the year in which shares were issued for a premium. So, the argument proffered that a young startup has no business engaging in such investments is myopic. In the guise of an exemption, the circular places a glass ceiling on growth and ordinary corporate activities. The choice for Indian entrepreneurs is now to either raise domestic capital but sacrifice competitiveness or raise only foreign capital and be exempt from these restrictions. The message from the tax department seems to be that one can startup in India, make in India but if you're Indian – please don't invest in India.

For those who may label this as alarmist, there are already situations faced by entrepreneurs wherein the assessing officers are questioning the exemption on the basis of these weak links. Worse off, the new Finance Act inserted a penalty of 200% of the premium in case a startup has its exemption revoked. Recent notices received by entrepreneurs as early as last month are asking startups to justify the fair market value of the securities without mentioning Section 56(2)(viib) – a clear indication that this issue hasn't died down, it's simply mutated to a more pernicious form. Even the recent notifications state that any tax officer can only open up proceedings on "Angel Tax" with the prior permission of their superior officer isn't relief, its bureaucracy with extra steps.

If the intention is to bring relief, then the February 2019 circular should be amended to state that loans and advances in the ordinary course of business should be allowed provided the PAN of the recipient is provided. On the issue of investing in shares and securities, if it's made into SEBI registered entities, then it should be allowed. Furthermore, any subsidiary or joint-venture should be precluded from investing in land, jewellery, buildings, etc – thus plugging the gap that startup can be used as a *via media* to make banned investments.

The current Finance Minister spoke about "Angel Tax" in the budget – the first time it was mentioned by name in any budget speech since 2012 – and has also stated that it has been dropped for registered startups. But unless these issues are resolved, this is a time-bomb waiting to explode. The devil is always in the details, not in the headlines – and the angels are nowhere to be found.

Link: Angel Tax isn't, merely deferred

Angel tax: Not dead, merely deferred

SIDDARTH PAI
Founding Partner, 3one4 Capital
Views are personal

NEVER HAS A tax displayed the flagrant disconnect between the bureaucracy and business like the angel tax does. In the measures to boost the Indian economy announced by the finance minister last week, angel tax found an explicit mention, causing entrepreneurs to rejoice that this ordeal is over. But the devil lies in the details, and the angel tax isn't dead—it is simply deferred.

Angel tax, or section 56(2)(viib) of the Income Tax Act, 1961, was an insertion by the UPA regime in 2012 as a means of checking the circulation of unaccounted funds through investments into private companies. It sought to attack "high share premium"—a supposed smoking gun of money laundering; instead, it turned out to be a red herring. A high share premium is the consequence of the mathematics underpinning valuation. Simple, legitimate corporate actions like having a small initial capital base and having a low face-value (both mainstays of any technology start-up) can translate into high share premiums. It is no more an indication of money laundering than having high-speed internet is an indication of online piracy.

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For those who may label this as alarmist, there are already situations faced by entrepreneurs wherein the assessing officers are questioning the exemption on the basis of these weak links. Worse off, the new Finance Act inserted a penalty of 200% of the premium in case a start-up has its exemption revoked. Recent notices received by entrepreneurs as early as last month are asking start-ups to justify the fair market value of the securities without mentioning Section 56(2)(viib)—a clear indication that this issue hasn't died down, it has simply mutated to a more pernicious form. Even the recent notifications state that any tax officer can only open up proceedings on "Angel Tax" with the prior permission of their superior officer isn't relief, it is bureaucracy with extra steps.

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FINANCIAL EXPRESS Mon, 26 August 2019 epaper.financialexpress.com/c/43503707

Section 68: The Devil in Angel Tax

Siddarth M Pai

As the entire Startup and Angel Investor ecosystem in India cheers the recent relaxations by the Tax authorities about "no coercive measures" to recover outstanding amounts and a clear deadline for the disposal of pending appeals by 31st March 2018, we must aware that every silver cloud has a dark lining. While many column inches have been dedicated to the angel tax (section 56(2)(viib)), none have spoken about a far more nefarious section: Section 68 (Unexplained Cash Credits).

Section 68 of the Income Tax Act, 1961 states that any sum credited to the books of accounts of an assessee can be charged to tax if:

- The assessee is unable to explain the source of the credit;

  OR

- The explanation is not **to the satisfaction of the Assessing Officer**

Extract of Section 68:

> *Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year*

Issue for Startups:

The issue for Startups arises specifically from the text which follows:

> ***Provided** that where the assessee is a company **(not being a company in which the public are substantially interested), and the sum so credited consists of share application money, share capital, share premium or any such amount by whatever name called,** any explanation offered by such assessee-company shall be deemed to be not satisfactory, unless—*
>
> > *(a) the person, being a resident in whose name such credit is recorded in the books of such company also offers an explanation about the nature and source of such sum so credited; and*
> >
> > *(b) such explanation in the opinion of the Assessing Officer aforesaid has been found to be satisfactory:*

Several startups, faced with the sword of section 56(2)(viib), also have to contend with section 68, which again allows for significant discretionary powers in the hands of the Assessing Officer, compounded by the discretionary powers already afforded by section 56(2)(viib). The link between the two sections actually **pierces the corporate veil of the Company,** wherein they need to obtain the books of accounts of their investors and explain to the tax authorities the source of the funds from the investors' perspective.
Some of the startups who have gotten notices under 56(2)(viib) have also received notices under section 68. The demand under 68 is harsher still as some of the Startups have been asked to provide the Income Tax Returns and bank statements or books of accounts of their investors for the past 3 years so that they can trace the source of the funds.

A Startups' Heart At-Tax

While Section 56(2)(viib) taxes any such excess premium in the hands of the Startups at the Maximum Marginal Rate, **Section 68 has a tax rate of 83.25%** as it falls under the provisions of Section 115BBE. 115BBE states that the income will be taxed at 60% and will be further increased by 25% surcharge, 6% penalty, i.e., the final tax rate comes out to be 83.25% (including cess). The 6% penalty won't be levied if the return of income and tax has been paid on or before the end of relevant previous year.

Conclusion

While the intent of Section 56(2)(viib) and Section 68 were to plug loopholes in the law to prevent the laundering of black money, Startups have inadvertently been caught in the crosshairs of these provisions as collateral damage. Thankfully, the Tax Department and Government have taken cognizance of this and are assuring all stakeholders that remedial measures will be instituted.

> *The fact that the Department stated that "no coercive measures" would be taken shows that they have the right intentions in mind and are looking to nurture the Startup ecosystem.*

Thus we are hopeful that while the Angel Tax provision gets rectified, the other associated sections should also be amended to ensure that law-abiding startups don't end up as collateral damage in the Government's campaign against Black Money.
After all, a tax is not the best form of defence.

Link: Section 68: The devil in Angel Tax

India's only Startup investment incentive is more red tape than red carpet

Siddarth M Pai

We broke away from License Raj in 1991, moving away from the constrained economy. But that break was partial.

\- Arun Jaitley

In no other situation is this partial break more evident than in the income tax benefits for startups and for investors into startups, Section 54GB of the Indian Income Tax Act, 1961. Touted before the budget as a tax break for investing into Indian startups, section 54GB can best be summed up from Macbeth, Act 5, Scene 5 – "full of sound and fury, signifying nothing."

This paper tiger of a clause exudes the erstwhile License Raj of India – a byzantine series of needless complications which seem attractive in theory but are untenable in practice.

In principle, the clause gives a tax exemption of Rs 50 lakhs (a small sum) for the investment of any capital gains into an eligible start-up. But where it errs is in the compendium of conditions that dilute the effect this clause would have had in galvanising startup investment in India:

- RESTRICTION ON THE TYPE OF GAINS ELIGIBLE:
  - The proceeds that can be invested should arise only from the sale of residential property or land (not any other asset)
- RESTRICTION ON THE COMPANY THAT CAN BE INVESTED INTO:
  - The investment needs to be made into an eligible startup, defined as any private limited company incorporated **after April 1st, 2016** and who has received IMB approval (so far, the success rate for this is around 1%)
- RESTRICTION ON THE SECURITY ISSUABLE:
  - The investment can only be made into equity shares (not preference shares, which is the preferred instrument for all startup investments)
- RESTRICTION ON MINIMUM OWNERSHIP:
  - **The investor should own 50% of the voting power of the start-up for the Rs 50 lakh invested!** (no founder will **ever** part with 50% of their company for Rs 50 lakh)
- RESTRICTION ON THE USE OF FUNDS:
  - The amount invested should be utilised by the eligible startup to purchase a new asset (plant and machinery), but **specifically excludes any and all computers and computer software** (clearly technology startups, which constitutes the bulk of all Indian startups, were never meant to be covered by this)
  - Any portion of the investment not used within 1 year of the investment to purchase said asset will be treated as income in the hands of the investor
- RESTRICTION ON EXITS:
  - The tax exemption lapses if the Company or shares is sold within 5 years and the entire amount invested becomes taxable

Whereas the rest of the world has simple schemes without any of the associated red tape, such as:

- UK - Seed Enterprise Investment Scheme (SEIS)
- US – Section 1202
- Singapore – Angel Investment Tax Deduction Scheme (AITD Scheme)

If the government is serious about galvanising Startup investment, which has already declined 48% in terms of the number of unique investors from 2015 to 2018, it needs to cut through all the red tape:

- Remove the need for IMB Certification (its success rate is abysmal and shrinks the eligible pool)
- Remove the restriction on type of securities (non-redeemable securities will suffice)
- Remove the restriction of minimum ownership (50% control for 50 lakhs is a complete non-starter)
- Remove the restriction of use of funds (no tech startup will buy plant and machinery and not computers or software)
- Have a carve out for the sale or merger of the entire company to an unrelated entity

The angel tax (section 56(2)(viib)) has hurt the confidence of Indian entrepreneurs and is leading to them shirking domestic investors for foreign ones, thus accelerating India's descent into a digital colony where all our innovative companies are wholly owned by foreign investors. Measures such as Section 54GB, that are supposed to boost domestic investment, are mere lip-service, destined to fail from the get-go.

In India, Startups and entrepreneurs have succeeded in spite of such inadequate policies, not because of it. But we all still live with the eternal hope that this gets reversed.

Link: India's Only Startup Investment Incentive Is More Red Tape Than Red Carpet