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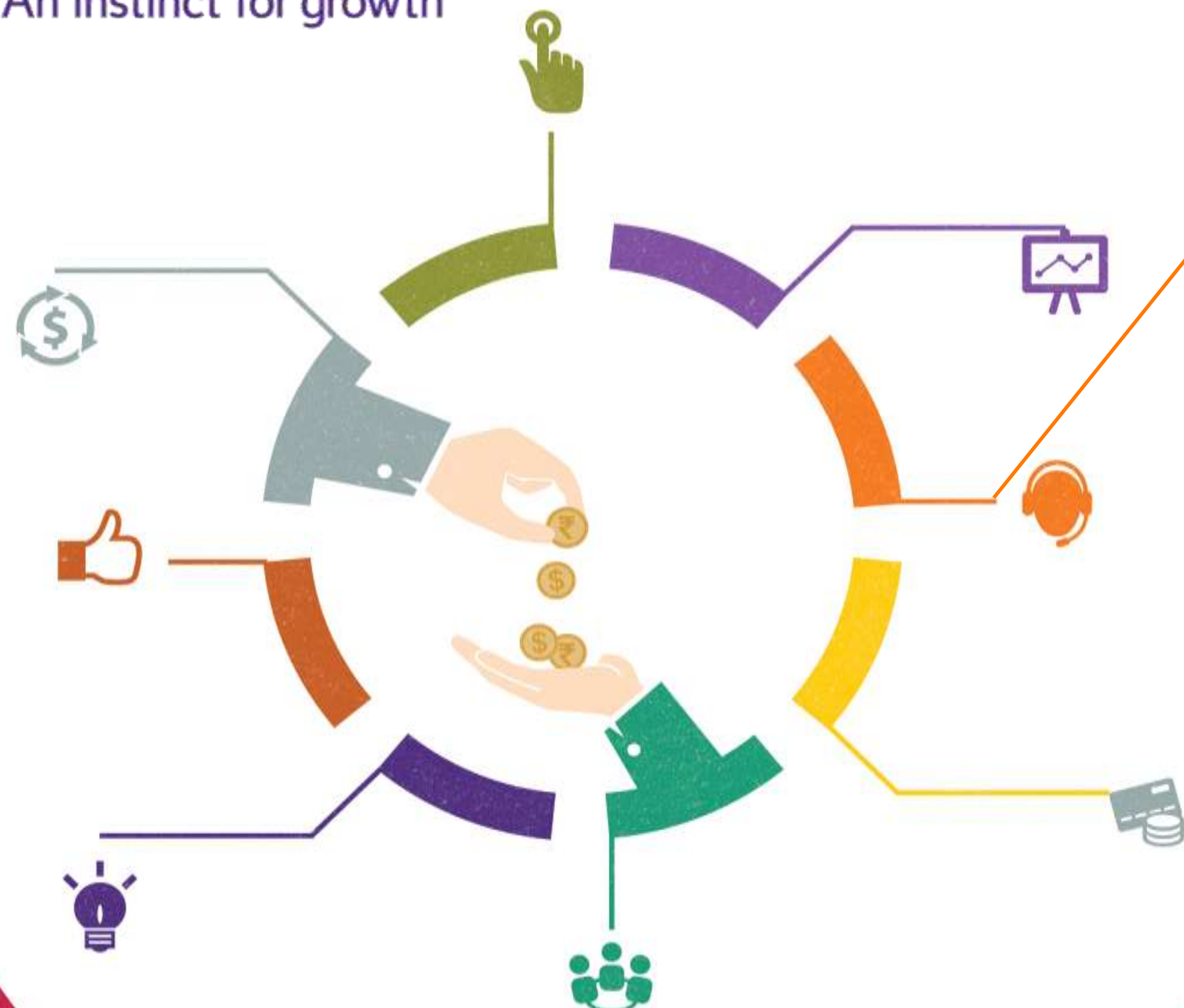
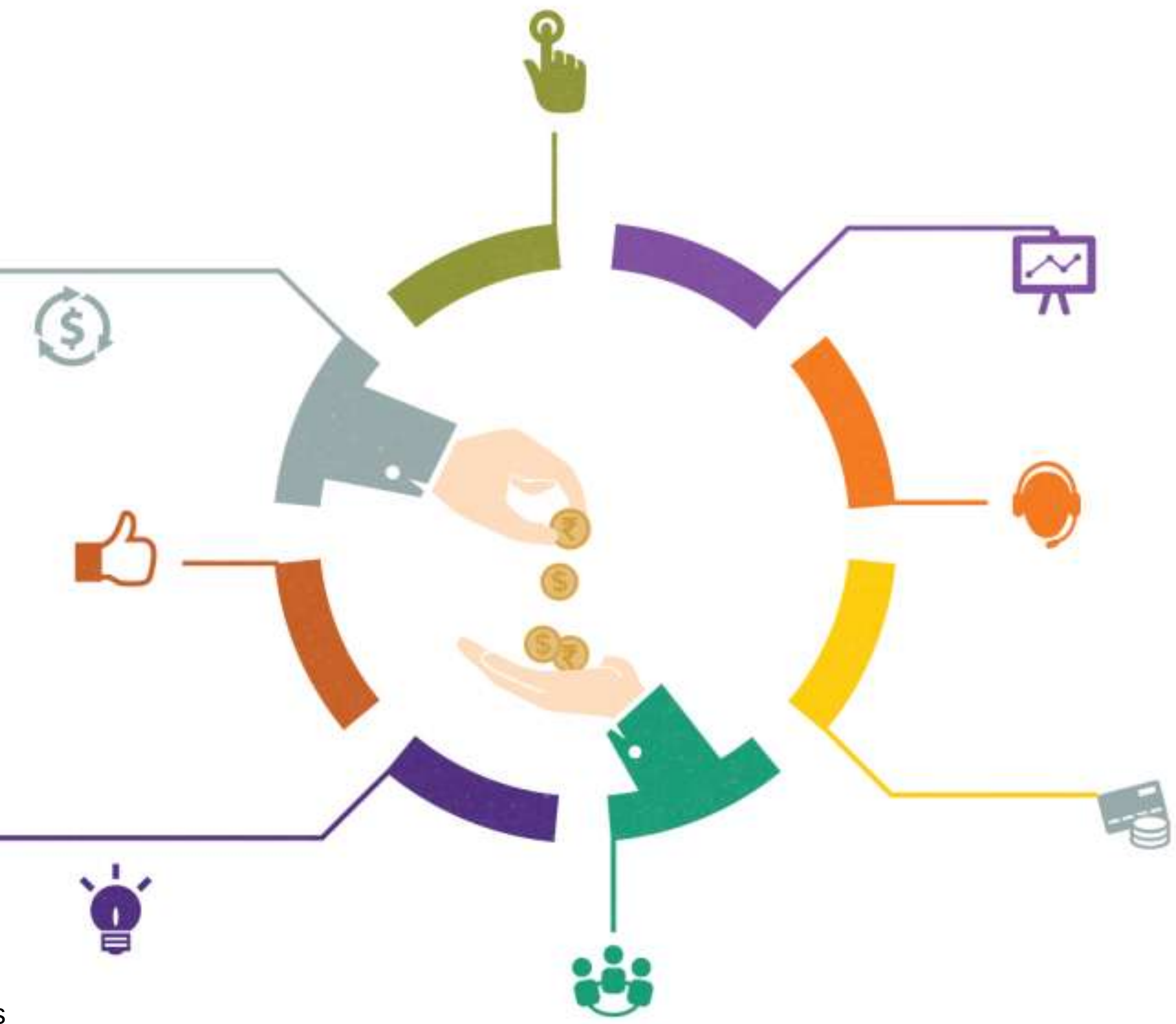


Union Budget 2015-16

Impact on the BFSI sector

Contents



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Sector overview

Sector overview

The Indian economy is on an upswing. The Indian stock exchange was ranked as the second-best performing stock exchange in 2014 amongst the major economies. The ranking provided an impetus to the expectations of the investor community from the Indian economy. The BFSI sector has been eagerly looking forward to the Budget, expecting big bang reforms and having a long wishlist of clarifications.

The vital factor in promoting investment in India is the deepening of the Indian bond market. The government is committed to bring the Indian bond market at par with the world-class equity markets.

A roadmap for accelerating growth, enhancing investment and passing on the benefit of the growth process to the common man has been proposed. This is the path which the government intends to pursue.

Growth drivers

The key growth drivers of the BFSI sector are as follows:

- GDP growth is expected to accelerate to 7.4% and would make India one of the fastest growing economies in the world
- Making India the manufacturing hub of the world by promoting 'Skill India' and the 'Make in India' programmes
- Setting up a Public Debt Management Agency (PDMA)
- Proposal to merge the Forwards Markets Commission with the Securities and Exchange Board of India (SEBI)

Sector overview

Challenges

Some of the major challenges faced by the economy in the prevailing conditions include the following:

- Keeping the inflation rate below 6%
- Meeting the projected GDP growth rate, between 8 to 8.5%, in 2015-16
- Maintaining fiscal deficit within the 2014-15 limit of 4.1% of GDP
- Deepening of the Indian Bond market to bring it at par with the equity market

Further, the five major challenges to the economy viz. agricultural income under stress, increasing investment in infrastructure, decline in manufacturing, resource crunch in view of higher devolution in taxes to state and maintaining fiscal discipline, need to be addressed.

From an indirect tax perspective, the single most important concern is difference of interpretation between Revenue authorities and the industry. Several players have been facing extended inquiries and proceedings with the Revenue authorities.

Furthermore, the restrictions on claiming and utilising CENVAT credits, particularly in the NBFC and insurance sectors also created a tax cascading effect of indirect taxes (specifically service tax) on business activities in the recent past.

Key expectations

Industry expectations

- Clarification on applicability of Minimum Alternate Tax (MAT) on foreign investors
- Abolition of MAT on general insurance companies to bring it at par with the MAT applicable on life insurance companies
- Deferral of General Anti-Avoidance Rules (GAAR)
- Extension of the period for applicability of concessional tax rate on the interest income earned by FPIs from investment in government securities and certain corporate bonds
- Rationalisation of provisions of Section 14A and Rule 8D
- Extending the tax pass-through status to all categories of AIF
- Clarifications under Section 194DA of the Income-tax Act,1961 (the Act) in case of partial surrender of pension plan and group insurance policy
- Requirement to hold securities by FPIs for a minimum period of three years to be withdrawn

Industry expectations

- Relaxation of CENVAT Credit Rules, particularly the restrictive provisions of 50% reversal, which is applicable to banks and deposit-taking NBFCs
- Clarification from the CBEC on "correspondent bank charges" where the industry believes that the service is in the nature of a Principal-to-Principal arrangement between correspondent banks and not in the nature of intermediary/ agency services provided by one bank to another
- Relief to the Life Insurance players who frequently face accumulation of CENVAT credits resulting in "hidden costs" in business operations
- Need for clarity on the extent and coverage of service tax on foreign exchange transactions, particularly in the case of foreign exchange derivative contracts such as cross-currency swaps, etc
- Certain imported items such as parts of ATMs, trading desks, etc to be provided customs duty relief/ concessions

Budget impact – Our view

- "The announcement of the Finance Minister to have a composite cap for investment through Foreign Portfolio Investors (FPI) and Foreign Direct Investment (FDI) will boost inflow of foreign funds in India with simplified processes. The sectors, wherein 100% foreign investment is allowed under the automatic route, will remain unaffected."

- "The Finance Minister has provided a much awaited relief to the fund managers envisaging to operate from India. The Finance Minister has proposed to exclude fund management activity carried out from India from the purview of 'business connection'. This would ensure that the mere presence of fund managers in India would not constitute taxable presence of the fund in India. The proposed clarity will bring India at par with the international standards."

Budget announcements – Key policy initiatives

Banks

- Micro Units Development Refinance Agency (MUDRA) Bank to be created with a corpus of Rs 20,000 crores and credit guarantee corpus of Rs 3,000 crores
- MUDRA Bank will be responsible for refinancing all micro-finance Institutions which are in business of lending to such small business entities through the Pradhan Mantri Mudra Yojana
- A Trade Receivables Discounting Systems (TReDS) to be established which will be an electronic platform for facilitating financing of trade receivables of MSMEs
- Comprehensive Bankruptcy Code of global standards to be brought in from the fiscal 2015-16 to improve the ease of doing business in India
- Postal network, with 1,54,000 points of presence spread across villages, to be used for increasing access of the people to the formal financial system

Non Banking Financial Companies (NBFC)

- NBFCs registered with the RBI and having asset size of Rs 500 crore and above may be considered for notifications as 'financial institution' in terms of the SARFAESI Act, 2002

Alternative Investment Funds (AIFs)

- Foreign Investment in AIFs to be allowed
- Distinction between different types of foreign investments, especially between foreign portfolio investments and foreign direct investments to be done away with and replaced with composite cap

Budget announcements – Key policy initiatives

Financial markets

- Public Debt Management Agency (PDMA) to be set up this year for bringing both external and domestic borrowings under one roof
- Enabling legislation included in the Budget, amending the Government Securities Act and the RBI Act
- Forward Markets commission to be merged with SEBI
- Section 6 of FEMA to be amended through Finance Bill to provide control on capital flows, as equity will be exercised by the government in consultation with RBI
- Proposal to create a task force to establish sector-neutral financial redressal agency that will address grievance against all financial service providers
- India Financial Code to be introduced soon in the Parliament for consideration
- Vision of putting in place a direct tax regime, which is internationally competitive on rates, without exemptions
- The government to bring enabling legislation to allow employees to opt for EPF or New Pension Scheme. For employees having monthly income below a certain threshold, contribution to EPF has been made optional, without affecting the employees' contribution
- Gold monetisation scheme to be introduced to allow depositors of gold to earn interest in their metal accounts and jewellers to obtain loans in their metal account; Sovereign Gold Bond, as an alternative to purchasing metal gold scheme, to be developed
- An autonomous Bank Board Bureau to be set up to improve the governance of public sector banks
- A new and more comprehensive Benami Transactions (Prohibition) Bill will be introduced which will enable confiscation of benami property and provide for prosecution. This will enable blocking a major avenue for generation and holding of black money in the form of benami property, especially in the real estate sector

Budget announcements - Direct tax proposals

Alternative Investment Fund (AIF)

Currently, only specified Category I AIFs are granted pass-through status. Pass-through status shall now be available to all classes of Category I and Category II AIFs which are regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012. The salient features of the proposed framework are as follows:

- Pass-through status:
  - All income of the AIF (except income under the head "profit from business and profession") shall have a pass-through status and income shall be taxed directly in the hands of the unit holder
  - The income shall be taxed in the hands of the unit holder under the same head of income as if the investment was made directly in the investee company
  - Profit from business and profession shall be taxed at the AIF fund level
- Withholding tax:
  - Payment to AIF by investee companies shall be exempt from withholding tax provisions
  - Income (excluding business income) payable to unit holders by AIF shall be subject to withholding tax @ 10%
- Loss, at AIF level, shall not be allowed to be passed through to the unit holders. However, such loss shall be eligible for set off and carry forward at the AIF level
- Dividend Distribution Tax and tax on distributed income shall not apply to income paid by the AIF to unit holders
- AIF shall be mandatorily required to file income tax return

Budget announcements - Direct tax proposals

Foreign Portfolio Investors (FPI)

In recent past there has been a debate on levying MAT on income of FIIs/ FPIs. While the FPIs were arguing that they are not subject to MAT, the Revenue authorities were in favour of levying MAT on their income.

MAT provisions are proposed to be amended to provide for exclusion of income of FPIs. However, short-term capital gains, which are not subject to Securities Transaction Tax (STT), would be subject to MAT.

MAT exemption to FPIs has been provided with prospective effect. It should have been a clarificatory amendment to mitigate past disputes as well.

Fund managers in India not to constitute business connection of offshore funds

Presently, an offshore fund is vary of having a fund manager based out of India. This is due to potential exposure of constituting a business connection of the fund in India on account of the fund manager's presence in India.

To promote offshore funds to have fund managers based out of India, it has been proposed that the fund management activity carried out through an eligible fund manager shall not, by itself, constitute a business connection in India. However, detailed conditions have been prescribed for its eligibility for this exemption.

The eligible investment fund is required to furnish information under Section 9A (5) to the prescribed authority. Failure to do so shall attract penalty of Rs 500,000.

This is a welcome clarification as it shall help in relocation of fund managers in India, as well as in enhancing job opportunities and the overall growth rate of the economy. However, the long list of conditions may act as deterrent to achieve the desired result.

Budget announcements - Direct tax proposals

Real Estate Investment Trusts (REITs) and Infrastructure Investment Trust (InvITs)

- Rental income earned by REITs shall have a pass-through status, being taxable in the hands of the unit holders
- No withholding tax on rental income earned by REITs from directly owned real estate assets - w.e.f. 1 June 2015
- Withholding tax on distribution of rental income (w.e.f. 1 June 2015)
  - Where unit holder is a resident, REIT to withhold tax @ 10%
  - Where unit holder is a non-resident, REIT to withhold tax as per rates in force
- Units received by Sponsors of REITs and InvITs on swap of shares in special purpose vehicles (SPV) shall be entitled to beneficial tax treatment whereby sale or transfer of such units shall be exempted from tax for long-term capital assets and taxed at 15% for short-term capital assets. This treatment will be available, provided the sale of such units has been subjected to STT

Nature of income	REIT and InvIT	Unit holders including sponsor
Interest from SPV	Exempt	Taxable as interest income Withholding tax to be deducted by REIT on distribution (Non-resident – 5%, Others – 10%)
Dividend	Exempt	Exempt
Capital gains on exit by REIT/ InvIT	At the rates applicable to capital gains	Exempt
Capital gains earned by unit holders on sale of REIT/ InvIT units including units held by Sponsors	Not applicable	For unit holders – long-term – exempt – short-term – 15%
Rental income	Exempt	Taxable at the applicable rates

Budget announcements - Direct tax proposals

Clarification on 'Indirect' transfers

The meaning of the term "substantially" with respect to transactions involving indirect transfer of assets in India has been clarified as follows:

- The value of assets (whether tangible or intangible) situated in India exceed Rs 10 crore **and** comprises at least 50% of the value of total assets (without reduction of any liabilities) of the foreign company, as on the valuation date
- Valuation date shall be the last day of the accounting period preceding the date of transfer. However, where the book value of assets on the date of transfer exceeds book value as on the last day of the accounting period by 15%, valuation should be done on the date of transfer
- The manner of determination of the fair market value of the Indian assets vis-à-vis global assets shall be prescribed in the rules

- The taxation of gains arising on transfer of a share or interest that derives, directly or indirectly, its value substantially from assets located in India, will be on proportional basis (computation mechanism to be prescribed)
- Indian entity to comply with prescribed reporting requirements in relation to indirect transfer, and failure to do so shall attract penalty
- The following transactions have been excluded from the ambit of indirect transfers:
  - **Transfer of direct holding company:** Non-resident transferor does not hold right of management, control, voting power or share capital exceeding 5%, at any time immediately preceding the 12 month period, in the direct holding company i.e. company directly holding shares in the Indian company

Budget announcements - Direct tax proposals

Clarification on 'Indirect' transfers

- **Transfer of indirect holding company:** Non-resident transferor does not hold right of management, control in such company, nor does he holds any right in such other company which would entitle him to right of management, control, voting power or share capital exceeding 5% in direct holding company
- **Amalgamation/ demerger:** Transfer of shares of a foreign company deriving substantial value from shares of an Indian company, in a scheme of amalgamation or demerger between two foreign companies, subject to prescribed conditions. Consequently, the cost of acquisition and the period of holding will be computed with reference to the original investment

Capital gains exemption on consolidation of Mutual Fund schemes

Transfer by a unit holder of a mutual fund in consideration of units received upon consolidation or merger of similar schemes of mutual funds shall not be regarded as a taxable event.

General Anti Avoidance Rule (GAAR)

Applicability of GAAR has been deferred to 1 April 2017. Further, all investments made till 31 March 2017 have been grandfathered and would be out of ambit of the GAAR provisions.

Clarification on 'Indirect' transfer is a welcome move. Specially, provisions relating to exclusion for small holdings and group restructuring through amalgamation and demerger would provide much needed relief. However, it would have been helpful if all group restructurings were exempted rather than only mergers and demergers.

Budget announcements - Direct tax proposals

Residential status for companies

A company shall be considered resident if it has place of effective management in India any time during the year. The term 'place of effective management (POEM)' has been defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in made.

Introduction of POEM concept for place of residency is as per international norms. Outbound investors would now need to meet the stricter requirement of having effective management in the country of investment.

Global Depository Receipts (GDR)

The SEBI definition of GDR has been amended to mean any depository receipt or certificate created by the Overseas Depository Bank outside India and issued to investors (resident as well as non-residents) against the issue of;

- ordinary shares of a company listed on a recognised stock exchange in India; or
- foreign currency convertible bonds of issuing company

However, the widened definition of GDR will not be able to avail tax benefits as envisaged for sponsored GDRs and listed companies.

Taxation of interest income of non-resident banking companies

It has been clarified that in case of a non-resident engaged in the business of banking, any interest receivable from Permanent Establishment of such non-resident in India shall be deemed to accrue or arise in India for such non-resident and accordingly will be taxable in India.

Budget announcements - Direct tax proposals

Income Tax Rates - Individuals:

- Basic rate of tax, slabs and education cess remain unchanged for all individuals
- Surcharge increased from 10% to 12% for individuals having taxable income exceeding Rs 1 crore

Income Tax Rates - Firm/ Local authorities:

- Basic rate of tax and education cess remained unchanged
- Surcharge increased from 10% to 12%, where the taxable income exceeds Rs 1 crore

Income Tax Rates - Individuals:

- Basic rate of tax and education cess remain unchanged
- Surcharge for domestic companies increased by 2% as under:
  - Surcharge @ 7% (if the taxable income > Rs 1 crore but < Rs 10 crore)
  - Surcharge @ 12% (if the taxable income > Rs 10 crore)
- Surcharge for foreign companies remain unchanged
- The Finance Minister proposes to phase out exemptions and reduce the corresponding Corporate Tax Rate from 30% to 25% over the next four years

Wealth Tax

- Wealth tax to be abolished

Proposal to reduce corporate tax along with phasing out of exemptions is a welcome step towards improving the ease of doing business in India. However, no roadmap has been laid out in this regard.

Budget announcements - Direct tax proposals

Withholding tax

- **Salary:** Employers shall obtain evidence/ proof or particulars of prescribed claims for computing tax deductible from salary to employees as against declaration from employees obtained earlier - w.e.f. 1 June 2015
- A new Section 192A proposes tax withholding on payment of accumulated balance due to an employee contributing to a recognised provident fund where the amount is withdrawn by the employee within five years from commencement. Tax withholding shall apply at the rate of 10% on payment in excess of Rs 30,000 - w.e.f. 1 June 2015
- It is proposed that the exemption provided from withholding of tax on payment of interest to members by the cooperative society under Section 194A shall not apply to the payment of interest on term deposits by the cooperative banks to its members
- Currently, as per Section 194C, tax withholding is not required on payments to contractors engaged in plying, hiring or leasing goods carriages, on furnishing of his Permanent Account Number (PAN) to the person making the payment. The exemption is now restricted to contractors owning ten or less goods carriages at any time during the relevant year - w.e.f. 1 June 2015
- Provision for lower withholding tax of 5% on interest on certain bonds and government securities paid to a Foreign Institutional Investors (FIIs) or a Qualified Foreign Investor (QFI) have been extended up to 30 June 2017
- Deduction of tax from interest payment on compensation awarded by the Motor Accident Claim Tribunal shall only be made at the time of payment, if the total amount of such payments during the financial year exceeds Rs 50,000
- Any amount paid to non-resident shall require the payer to provide information in the prescribed format to the revenue authorities irrespective of whether such payment constitutes income in the hands of the payee or not
- Definition of Time Deposits amended to include recurring deposits. Accordingly, tax is required to be deducted on interest on recurring deposits exceeding the threshold limit of Rs 10,000

Income of core Settlement Guarantee Fund (SGF) of the clearing corporation to be exempt in certain cases

Income of the Core SGF arising from the contribution received and investment made by the fund and the penalties imposed by the Clearing Corporation will be exempt subject to certain conditions. Core SGF will lose the exemption if the amount standing to its credit is shared with the specified person in the year in which the amount is so shared.

Budget announcements - Direct tax proposals

Tax avoidance

Various measures to discourage cash transactions have been introduced , which are detailed as follows:

- Acceptance of advance of Rs 20,000 or more in cash for purchase of immovable property shall attract penalty equivalent to the amount of such receipt
- Quoting of PAN has been made mandatory for any purchase or sale of immovable property exceeding a value of Rs 1 lakh
- A new comprehensive Benami Transactions (Prohibition) Bill is proposed to be introduced to cover benami property especially in real estate
- Further, a new law is proposed on control of black money and its salient features are as follows:
  - Prosecution for default with punishment of rigorous imprisonment up to 10 years
  - Offences under this bill shall be non-compoundable
  - The defaulter cannot approach the Settlement Commission
  - Penalty shall be levied @ 300% of tax evaded
  - Foreign assets will be required to be disclosed in the tax return and non-compliance shall attract prosecution and rigorous imprisonment of up to 7 years
  - Income from such undisclosed foreign asset shall be taxed at the maximum marginal rate without any exemptions or deductions
  - Beneficiaries of foreign assets shall be mandatorily required to submit return of income even if there is no taxable income
  - Date of opening of foreign account mandatorily required to be specified by the assessee in the return of income
  - Any offence under this bill shall be treated as an offence under the Prevention of Money-laundering Act, 2002 (PMLA) enabling attachment and confiscation of unaccounted assets held abroad. The offence would also attract prosecution
  - Suitable amendments under FEMA are also envisaged to permit confiscation of equivalent Indian assets and levy of penalty along with prosecution with punishment of imprisonment up to five years

Budget announcements - Indirect tax proposals

Budget amendments

Service tax

(Effective from a date to be notified after enactment of the Finance Bill, 2015)

- Rate of service tax increased from 12.36% (inclusive of all cess) to 14% (subsuming all cess)
- Additional 2% tax proposed to be charged on taxable service value in the form of Swachh Bharat cess (SBC)
- Consequent changes made in various composition rates of service tax as provided in the table:

Particulars	Pre-budget rate	Post-budget rate
Life insurance - first year - subsequent years	 3.00% 1.50%	 3.50% 1.75%
Money changer - up to Rs 100,000 - Exceeding Rs 100,000 and upto Rs 1,000,000 - Rs 1,000,000 or more	 Minimum Rs 30 or 0.12% Rs 120 plus 0.06% of sum exceeding Rs 100,000 Rs 660 plus 0.012% of sum exceeding Rs 1,000,000 (subject to max. of Rs 6000)	 Minimum Rs 35 or 0.14% Rs 140 plus 0.07% of sum exceeding Rs 100,000 Rs 770 plus 0.014% of sum exceeding Rs 1,000,000 (subject to max. of Rs 7000)

Budget announcements - Indirect tax proposals

Budget amendments

Service tax

(Effective from 1 April 2015, unless specified otherwise)

- Change in "reverse charge" percentage for certain services prescribed as follows:

Particulars	Pre-budget rate		Post-budget rate	
	Service provider	Service recipient	Service provider	Other than service provider
Manpower services (by non-corporates)	25%	75%	0%	100%
Mutual fund agent	No reverse charge applicable		0%	100%
Mutual Fund (MF) Distributor to MF or AMC			0%	100%

Note: Important change in reverse charge table is replacement of "service recipient" with "other than service provider" nomenclature

- Exemption to life insurance service provided by way of Varishtha Pension Bima Yojana

(Effective from date of enactment of the Finance Bill, 2015, unless otherwise specified)

- Definition of 'consideration' expanded to include reimbursements charged in course of providing taxable service
- Where service tax disclosed as payable in returns but amounts not paid, coercive measures of recovery could be initiated without issuing demand notice
- Applicability of service tax on services provided by a foreman of chit fund for conducting/ organising the chit on full consideration received without applying abatement rates
- Discretion to levy penalty under Section 80 available to Revenue authorities to be removed

Budget announcements - Indirect tax proposals

Budget amendments

Service tax

(Effective from date of enactment of the Finance Bill, 2015, unless otherwise specified)

- Penalty provisions rationalised in favour of the taxpayer in the following manner:

Event	Amendment
Notice to recover service tax not paid/ short paid (a) in cases not involving fraud, etc.	If disputed service tax paid within 30 days from receipt of Notice (a) No penalty to be charged (If disputed service tax paid after 30 days in cases not involving fraud, penalty reduced from 50% to 10%)
(b) in cases involving fraud, etc	(b) penalty reduced from 100% to 15% in cases where fraud involved
Order passed for recovery of service tax	If service tax paid within 30 days of the Order, penalty reduced to 25% of amount demanded in said Order

CENVAT credit

(Effective from 1 March 2015, unless otherwise specified)

- The period of availing CENVAT credit on inputs and input services extended from six months to one year from date of invoice/ challan or other specified documents
- CENVAT credit of service tax paid under domestic reverse charge now allowed to the claimant, without linking it to the payment of services to the input service provider (effective from 1 April 2015)
- Effective from 1 April 2015, CENVAT credit wrongly taken (i.e. availed) or utilised by manufacturer or output service provider to attract recovery proceedings under Central Excise Act and Service Tax Law respectively with similar penalties. Thus, re-enforcing the earlier verdict of the Supreme Court

Budget announcements - Indirect tax proposals

Budget amendments

CENVAT credit

(Effective from 1 March 2015, unless otherwise specified)

- For the purpose stated above, CENVAT credit taken would be deemed to have occurred on last day of the month and utilisation would follow the following hierarchy:
  - Opening balance of month to be utilised first
  - Credit admissible under CENVAT Credit Rules (CCR) taken during the month to be utilised next
  - Credit inadmissible in terms of CCR taken during the month utilised thereafter
  - Parts and components of cash dispenser and automatic bank note dispensers exempt from Basic Customs Duty

Customs duty

(Effective from 1 March 2015, unless otherwise specified)

- Effective rate of customs duty increased from 28.85% to 29.44% (see table below)

Particulars	Pre-budget rate	Post-budget rate
Value of goods (assumed)	100	100
Basic customs duty	10	10
Value for computing additional duty of customs (in lieu of excise)	110	110
Additional duty of customs (in lieu of excise)	13.2	13.75
Education cess	0.70	0.71
Special additional duty (in lieu of sales tax)	4.95	4.98
Total	128.85	129.44
Effective rate *	**28.85**	**29.44**

Budget announcements - Indirect tax proposals

Budget amendments

Customs duty

(Effective from 1 March 2015 onwards)

- Automatic Teller Machines (ATMs), printed circuit assemblies for ATMs exempt from special additional duty (SAD), in lieu of value added tax (VAT), subject to actual user condition

(Effective from date of enactment of the Finance Bill, 2015; unless otherwise specified)

- Settlement Commission not to hear matters where Appellate Authority has remanded cases back to Adjudication Authority for *de novo* assessment
- Class of persons eligible to approach the Advance Ruling authority now includes specified Resident partnership firms as defined under the Customs Act
- Certain sections pertaining to Settlement Commission removed since they were redundant

- Penalty provisions rationalised in favour of taxpayer in the following manner:

Event	Amendment
Notice to recover duty not paid/ short paid or erroneously refunded (a) in cases not involving fraud, etc. (a) in cases involving fraud, etc	If disputed duty and interest paid within 30 days from receipt of Notice (a) penalty waived and proceedings dropped where fraud not involved (b) penalty reduced from 25% to 15% in cases where fraud involved
Order passed on any person for **improper import or export** of dutiable goods who has possession or is any way concerned with such improper import/ export	Penalty reduced in all cases to 10% of duty or Rs 5,000, whichever is higher If payment of duty and interest made within 30 days from Order, penalty further reduced 25% of penalty mentioned in the Order

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About Grant Thornton

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