Union Budget 2016-17

Impact on the banking, financial services and insurance sector

Contents

Foreword

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The Union Budget 2016-17 has a mixed bag for banking and financial services and insurance sector. With respect to policy initiatives and reforms a lot has been promised. Success of certain policy initiatives such as comprehensive code on resolution of financial firms, statutory basis for monetary policy framework, setting up of a financial data management centre and retail participation in Government securities will depend on effective implementation. Adequacy of recapitalization allocation for PSU banks and increased limit of foreign investment in insurance and pension sector needs to the tested in the financial economy The Hon'ble Finance Minister, during his last Budget, had proposed a number of reforms which are yet to be operational or in some cases conceptualized such as, India Financial Code; Bank Board Bureau, setting up of Public Debt Management agency, etc.

Clarification of taxation has been provided in respect of MAT on foreign companies, reduction in holding period of unlisted shares, applicability of residency rule for foreign companies, DDT exemption to SPVs of REITs. The Budget also provided a pass through status to securitization and asset reconstruction trust. In addition to this, NBFCs have been provided with 5% provision for bad and doubtful debts.

While on the other hand, investors have been burdened with additional dividend tax of 10% amounting to three layers of taxation, securities transaction tax for option transactions increased to 0.05%. The levy of surcharge too increased to 15% for individual, HUF, AOP and BOI having annual income of above one crore.

To sum it all, the proposals of Finance Minister has given financial sector a little to cheer which is far away from the industry expectation. Clearly more was expected for the sector.

An overview

The developments across the banking, financial and insurance services (BFSI) sector is transforming the Indian economy. Some key highlights[1]:

- The BFSI sector contributed nearly 6% to the country's gross domestic product (GDP) in 2014-15.
- The size of banking assets in India reached US$ 1.46 tn as in November 2015. It is expected to touch US$ 28.5 tn by fiscal 2025.

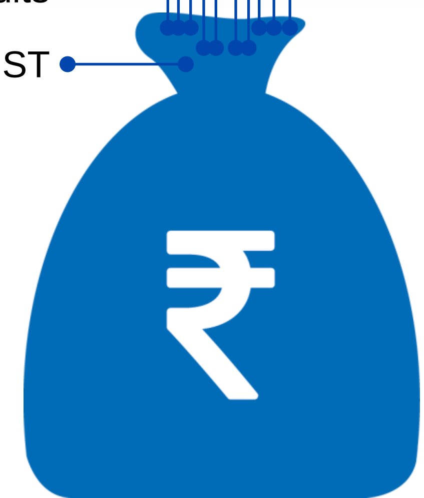
Some of the significant measures taken by the government last year were:

- Simplification of procedures and prescribing uniform registration for the entry for Foreign Portfolio Investors (FPIs)
- Composite cap on FDI in the insurance segment increased to 49% from 26%
- Launching of "e-sahyog" pilot project
- Setting up of a committee to simplify Income-Tax provisions
- Clarification on taxability of off-shore rupee denominated bonds
- Revised monetary limit for appeal to Tribunal, High Court and Supreme Court to discourage litigations
- Transfer pricing rules to incorporate "range concept" and use of "multi year data" to reduce litigation

Source: 1- India Brand Equity Foundation (IBEF) report

Key challenges

- Discrimination in taxation of pension and non-pension product
- Taxation of income distributed by Securitisation Trusts
- Interpretation of laws between revenue authorities and the industry
- Prolonged inquiries and proceedings with the revenue authorities
- Restrictions continue on claiming and utilising CENVAT credits
- Implementation of GST
- Rising bad loans and sluggish profits
- Implementation of income computation and disclosure standards
- Little clarity on place of effective management (POEM)
- No clarity on rule 8D allowing expenditure incurred to earn exempt income
- Non-applicability of MAT



Growth drivers

- Better corporate governance and effective framework
- Implementation of GST to promote export, create employment opportunities and encourage competition
- Continued growth in equities and innovative products
- Rising income with growth of wealth services
- Widening reach across various segments to benefit the insurance sector
- 'Skill India' and 'Make in India' programmes promote India as the manufacturing hub

Key policy initiatives

Banks

- A comprehensive code on Resolution of Financial Firms to be introduced
- Bank Board Bureau to be operationalised during 2016-17
- Statutory basis for Monetary Policy Framework and Monetary Policy Committee
- Roadmap for consolidation of Public Sector Banks to be spelt out
- Rs 25,000 crore allocated towards recapitalization of Public Sector Banks
- Sponsor of Asset Reconstruction Companies (ARC) to hold 100% stake and permit non-institutional investors to invest in Securitisation Receipts
- Massive rollout of ATMs and Micro ATMs in Post Offices over next three years
- 100% FDI in Asset Reconstruction Companies (ARCs) is proposed to be allowed under automatic route (*presently FDI beyond 26 % & up to 49% is under approval route*)

Insurance

- Listing of general Insurance companies owned by Government
- Automatic route for FDI upto 49% in insurance and pension sectors subject to the extant guidelines on Indian management and control. (presently FDI beyond 26% & upto 49% is under approval route)

Key policy initiatives

Capital markets

- Permissibility of FDI in NBFC activities is proposed to be enhanced beyond the existing 18 specified activities
- Setting-up of financial data management centre
- RBI to facilitate retail participation in Government securities
- SEBI to develop new derivative product in Commodity Derivatives Market
- Legislation to deal with menace of illicit deposit taking schemes
- Members and benches of Securities Appellate Tribunal to be increased
- FPIs to be permitted 100% of each tranche in securities receipts issued by ARC's subject to sectoral caps
- Increase in investment limit in Indian stock Exchanges for foreign entities from 5% to 15%
- Investment by FPIs in Central Public Sector (other than banks) increased to 49%
- The basket of eligible FDI instruments is proposed to be expanded to include hybrid instruments subject to certain conditions.(The
- present basket includes equity shares, fully and mandatorily convertible debentures, fully and mandatorily convertible preference shares and warrants)
- Foreign investors will be accorded residency status subject to certain conditions (currently foreign investors are granted business visa only up to 5 years at a time)
- Measures for deepening of bond market:
  - LIC to set up a dedicated fund to provide credit enhancement to infrastructure projects
  - RBI to issue guidelines to encourage large borrowers to access market mechanism
  - FPIs to allow investment in unlisted debt securities
  - For developing an enabling eco system for the private placement market in corporate bonds, an electronic auction platform will be introduced by SEBI for primary debt offer
  - A complete information repository for corporate bonds, covering both primary and secondary market segments will be developed jointly by RBI and SEBI
  - Electronic platform for repo market in corporate bond to be developed by RBI

Direct tax proposals

Income Tax Rates

Individuals, HUF, AOP & BOI

- Tax Slabs remain unchanged
- Surcharge increased from 12% to 15% with total income exceeding Rs 1 crore (increasing effective marginal rate to 35.534% from 34.608%)

Corporates

- Tax rate reduced by 1% to 29% for domestic companies with a total turnover/gross receipts of upto Rs 5 crore in FY 2014-15
- Option for newly set up domestic companies engaged solely in manufacture or production to be taxed at 25% resulting in a 5% reduction in rate - the company should not avail of specified tax incentives
- No other changes in corporate tax rates or surcharge

Other taxpayers

- No change in tax rates and surcharge for firms, LLPs and co-operative societies

Marginal increase in surcharge for a specified category of taxpayer having income exceeding Rs 1 crore

Deferral of Place of Effective Management (PoEM) regulations

- Applicability of Place of Effective Management (POEM) based residence test to be deferred by one year to FY 2016-2017 in the absence of implementation guidelines. The government to notify rules providing for the transition mechanism for a company which becomes tax resident of India on account of its POEM.

Holding period for unlisted shares

FM has announced as part of his speech that holding period for unlisted shares to qualify as long term asset would be reduced to 2 years as compared to 3 years currently. However, this proposal is not covered in the bill as it was laid down before the parliament.

Rationalisation of taxation regime for offshore funds

- Conditions for offshore funds not constituting place of business in India has been liberalised to include funds domiciled in a country or territory specified by the Government. Further, the limitation of carrying on control or management of business from India by the fund has been removed
- Amendment to apply from FY 2016-17 onwards

While relaxation of these conditions addresses some of the issued faced by foreign funds, conditions relating to corpus size and investor base remains unchanged

Non Banking Finance Companies

- Deduction in respect of provision for bad and doubtful debts proposed to be allowed to Non-Banking Financial companies (NBFC) up to 5% per cent of the total income, on similar lines as available to public financial institutions, state financial corporations and state industrial investment corporations

New tax regime for securitisation trusts

- Income continues to be exempt in the hands of the securitisation trust and taxable in the hands of its investors
- Tax to be withheld at 25 percent in case of payments to resident individual/HUF investors and at 30 percent for other investors. In case of non residents investors, tax to be deducted at applicable rates in force.
- Option for the investor to obtain low or Nil deduction of tax certificate

Promotion of International Financial Services Centres

- Exemption from capital gains tax on foreign currency transaction undertaken on recognised stock exchange in IFSC, even if no STT is paid
- Reduced MAT rate of 9 percent (instead of 18.5 per cent) for IFSC unit earning only foreign currency income coupled with exemption from DDT

Minimum Alternate Tax on foreign companies

- In line with the CBDT circular accepting recommendation of A P Shah Committee, it has been proposed to keep foreign companies not having PE / registered place of business in India outside the purview of Minimum Alternate Tax. This provision is applicable from FY 2000-01

Rupee Denominated Bonds

Capital gains arising from appreciation of rupee against the foreign currency of investment between the date of issue and redemption shall be exempt from capital gains tax

Exemption on switching of mutual fund plan on consolidation

Transfer of units due to consolidation of plans and units in consolidated plan of that scheme of the mutual fund shall not be considered to be a transfer eligible to capital gains tax

Exemption from capital gain tax on Sovereign Gold Bonds

- Gains on redemption of Sovereign Gold Bond Scheme to be exempted from capital gains tax. Indexation benefit shall also be available on long term capital gains arising on transfer of Sovereign Gold Bonds

Gains from transfer of Sovereign Gold Bonds will be exempt if redeemed, else indexation benefit is available for other modes of transfer. These measures will help meet the objective of encouraging people to invest in these bonds instead of physical gold

Additional tax on dividend income

- It has been proposed to levy tax on income by way of dividend earned by resident individual, HUF or a firm at the rate of 10% wherein dividend received is in excess of Rs 10 lakhs

Investors have been burdened with additional dividend tax of 10% amounting to multiple layers of taxation viz on profits of the company, dividend distribution tax and finally taxable in the hands of the investors

Boost for REITs

- **DDT exemption to SPVs of REITs:** Distributions made out of income of asset-owning SPV to Listed Real Estate or Infra Investment Trusts (REITs & INVITs) will not be subjected to Dividend Distribution Tax (DDT)

Exemption from payment of dividend distribution tax by SPV to REITs and InvITs is one of the positive amendments which removes the hurdles and provides impetus to the REIT industry

Concessional rate of tax on gains from sale unlisted securities

It has been specifically provided that the long term capital gains, arising to non-residents from the transfer of capital asset being unlisted securities or shares of a company not being a company in which public are substantially interested, shall be taxable @10%

Buy-back tax

- The scope of levy of buy-back tax has been widened to cover any buy-back irrespective of applicable provisions of the Companies Act.
- Buy-back tax shall continue to be levied at 20% on distributed income
- Amendment proposed to be effective 1 June 2016

Proposal seeks to bring clarity on the buy-back tax regime with a view to curbing practice of undertaking buy back through court process merely to mitigate the existing buy-back tax

Other amendments

- **TDS rate for payments by AIF to non-resident investors:** It is clarified that payments made by AIF to its investor / unit holders shall be subject to withholding tax at the rates applicable under the relevant tax treaty, if more beneficial.
- **PAN furnishing requirement for non-residents:** It is proposed to accept alternate documents in the absence of PAN to obviate withholding tax at the higher rate
- Rate of securities transaction tax on sale of an option in securities where option is not exercised is increased from 0.017% to 0.05%

Indirect tax proposals

Introduction of new provisions

(Effective from 1 June 2016 after enactment of the Finance Bill 2016 unless specified otherwise)

- Proposed levy of Krishi Kalyan Cess (KKC) @0.5% of the value of taxable services with the effect from 1 June 2016.
- It is proposed that KKC paid on input services adjustable against output KKC liability

Effective from date of enactment of Finance Bill, 2016

- Indirect tax Dispute Resolution Scheme, 2016, has been introduced to cover all disputes pending at the level of Commissioner (Appeals) as on 01 March 2016 under the Customs Act, the Central Excise Act and under the Service Tax Law
- Assesse to file declaration pertaining to each order within prescribed timelines and pay tax along with interest and 25% of penalty
- Proceedings against the assessee will be closed, immunity from prosecution will be granted and balance penalty of 75% would also be waived off
- However, this scheme will not apply in cases where prosecution has already been instituted before 01 June 2016, offences involving narcotics & psychotropic substances, etc.

Indirect tax proposals

Interest on delayed payment of duty

(Effective from the date of enactment of Finance Bill 2016)

- Interest rate on delayed for short payment or non payment of duty/tax across all indirect taxes are being rationalized and made uniform at 15%, except in case of Service Tax collected but not deposited to the exchequer

Particulars	Pre-budget rates	Post-budget rates
Customs duty	18%	15%
Excise duty	18%	15%
Service Tax	18% 24% 30%	15% 24% (if tax collected but not deposited with the government

Indirect tax proposals

Reversal of CENVAT Credit under Rule 6 of CENVAT Credit Rules, 2004 (CCR)

(Effective from 1 April 2016)

- For banks, financial institutions and non-banking finance companies, option given to either follow method of CENVAT reversal tabulated below or opt for 50% of eligible credits of inputs and input services to be reversed

CENVAT Credit attributable to	CENVAT Credit availability
Exclusively exempted goods / services	Not allowed in entirety
Exclusively non-exempted goods / services	Allowed in entirety
Common CENVAT credit	To be reversed in the ratio of exempted turnover to sum of exempted and non-exempted turnover for the previous financial year *

**where no activity is done in the previous financial year, then CENVAT credit should be reversed to the extent of 50% of common credit*

- Monthly reversal basis previous year's turnover required to be done
- Interest rate for non-reversal of CENVAT credit reduced to 15% p.a. from 24% p.a.

Indirect tax proposals

Limitation for filing refund claims under Rule 5 of CCR

(Effective from 1 March 2016)

- Time limit for filing application for refund of CENVAT credit under Rule 5 of CCR for service provider has been amended
- Service providers can file refund claim before the expiry of one year from the following dates:
  - Date of receipt of payment, where service has been already provided
  - Date of issue of invoice, where payment has been received in advance prior to issuance of invoice

Filing of Annual Returns

- Service provider required to file annual CENVAT return by 30 November of succeeding year in format to be prescribed

Indirect tax proposals

The following services are exempted from service tax

(Effective from 1 April 2016)

Particulars	Pre-budget rate	Post-budget rate
The service of life insurance business provided by way of annuity under the National Pension System regulated by Pension Fund Regulatory and Development Authority (PFRDA) of India	3.5%	Nil
Services provided by Insurance Regulatory and Development Authority (IRDA) of India	14%	Nil
The regulatory services provided by Securities and Exchange Board of India (SEBI)	14%	Nil
Single premium annuity (insurance) policies in cases where the amount allocated for investment, or savings on behalf of policy holder is not intimated to the policy holder at the time of providing of service	3.5%	1.4%
The general insurance services provided under 'Niramaya' Health Insurance scheme launched by National Trust for the Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disability in collaboration with private/public insurance companies	14%	Nil

Indirect tax proposals

Reverse charge mechanism

(Effective from 1 April 2016)

- Service provider would be liable to discharge Service tax liability in case of the following services earlier covered in the Reverse charge mechanism:

Particulars	Liability to pay service tax under reverse charge	
	Pre-budget	**Post-budget**
Service provided to Asset management Companies	Asset Management Company	Mutual fund agents/ distributors
Service provided by a senior advocate to business entity	Business Entity	Senior Advocate

- All the services provided by Government or Local Authorities would be taxable. Further the service recipient would be liable to discharge service tax liability in case of the said services.

Indirect tax proposals

Filing of Annual Returns

(Effective from 1 April 2016)

- All assessees other than those notified, would be required to file Annual return on or before 30 November of the subsequent financial year
- A revised annual return may be filed within one month from the date of filing the original return
- Late fee of Rs 100 per day not exceeding Rs 20,000 prescribed for delay in furnishing the annual return

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