KPMG

Union Budget 2018-19

Our Point of View

Financial Services

Equating sustainable economic growth and better life quality

India is currently the seventh largest economy worth USD2.5 trillion and is soon expected to become the fifth largest in the world. As per the Union Budget 2018-19, India is now firmly on course to achieve high growth of above 8 per cent.

Nearly 70 per cent of India resides in rural areas, contributing 50 percent of India's Gross Domestic Product (GDP) and consumption. As per International Monetary Fund's (IMF's) World Economic Outlook – January, 2018, India's GDP growth will be at 7.4 per cent in FY18-19.

For India to reach a sustainable double digit growth in the medium to long-term and to achieve an enhanced quality of life, it is critical that economic activity in rural areas has to increase substantially along with continuous structural reforms and rigorous implementation.

The Union Budget 2018-19 emphasizes the need for developing a robust ecosystem with a strengthened agricultural and rural sector, of healthy and educated citizens, with abundant employment opportunities, with robust Micro Small and Medium Enterprise (MSME) segment and strong infrastructure sector. The reforms of the Budget place stress on 'Ease of Living' for the common man of this country, especially the less privileged.

Technology will be one of the biggest drivers of the reforms towards achieving their goals. In the Financial Services sector break-through technologies such as Artificial Intelligence, Fintech and blockchain will create waves of innovation. It is important to create public blockchains which private blockchains could leverage for realising potential synergies.

Cryptocurrencies pose considerable risks as potential vehicles for money laundering, terrorist financing, tax evasion, circumvent exchange controls and capital flow management. Regulators have a variety of approaches across countries to mitigate/address these challenges. For instance, issuing warnings to consumers, completely banning the use of crypto-currencies, prohibiting financial institutions from dealing in crypto-currencies etc. There is a need to ensure that local regulations does not stifle innovation.

Budget impact –Banks and NBFCs

- Priority sector lending - MSME and Agriculture financing
  - The decrease in corporate tax rates to 25 per cent for MSMEs has rewarded their balance sheets with higher availability of residual 'profits after tax' which can be ploughed back into strategic investments and business expansion leading to higher credit-offtake.
  - Refinancing policy and eligibility criteria set by MUDRA will be reviewed for better refinancing of NBFCs. This will help NBFCs increase their exposure to MSME segment and help grow their client base.
  - It is proposed to onboard public sector banks and corporates on Trade Electronic Receivable Discounting System (TReDS) platform and link this with GSTN. Online loan sanctioning facility for MSMEs will be revamped for prompt decision making by the banks. This will ensure better turnaround and operational efficiency in loan disbursing to MSMEs.

- Government will soon announce measures for effectively addressing non-performing assets and stressed accounts of MSMEs. This will help lighten the burden of NPAs in the banking system to a certain extent.
- Government has been steadily increasing the volume of institutional credit for the Agriculture sector, which the Budget currently pegs at INR11 lakh crore for FY2018-19. The Ministry of Agriculture and Farmers' Welfare will promote cluster based development of agricommodities and regions in partnership with the Ministries of Food Processing, Commerce and other allied Ministries. Government will promote establishment of specialised agro-processing financial institutions in this sector. India has agri-export potential of USD100 billion against current exports of USD30 billion. The Banking and Financial Services Industry (BFSI) players can be expected to accordingly align their operating strategy in this segment.
- The NITI Aayog, in consultation with state Governments, will evolve a suitable mechanism to enable access of lessee cultivators to credit without compromising the rights of the land owners. This is expected to increase disbursement of crop loans at lower cost to lessee cultivators.
- Other measures to boost MSME finance include measures for development of Fintech companies and Alternate Investment Funds (AIFs) environment in India.

Budget impact –Insurance and pensions

- Differentiated and specialised insurance products that are focused on senior citizen wellness may see new beginnings with enhanced tax benefits in this area under section 80D
- Listings and IPOs - Three public sector general insurance companies National Insurance Company Ltd., United India Assurance Company Limited and Oriental India Insurance Company Limited will be merged into a single insurance entity and will be subsequently listed. The Government has approved listing of two insurance companies on the stock exchanges. This will help bring in economies of large scale, efficiency and transparency; while unlocking their value to the Government exchequer.
- Insurance penetration to the bottom of the pyramid
  - Government to launch a flagship National Health Protection Scheme to cover over 10 crore poor and vulnerable families (approximately 50 crore beneficiaries) providing coverage upto 5 lakh rupees per family per year for secondary and tertiary care hospitalisation. This will be the world's largest Government funded health care programme.
  - .Micro Insurance and pensions - The Government will expand the coverage under Prime Minister Jan Dhan Yojana by bringing all sixty crore basic accounts within its fold and undertake measures to provide services of micro insurance and unorganised sector pension schemes through these accounts.
  - Pradhan Mantri Jeevan Jyoti Beema Yojana (PMJJBY) has benefitted 5.22 crore families with a life insurance cover of INR2 lakh on payment of a premium of only INR 330 per annum. Likewise, under Pradhan Mantri Suraksha Bima Yojana, 13 crore 25 lakh persons have been insured with personal accident cover of INR2 lakh on payment of a premium of only INR12 per annum. The Government will work to cover all poor households under these missions.

Budget impact – Capital Markets

- Primary bond Market - The Budget proposes that regulators should start permitting bonds with 'A' grade ratings to be eligible for investments and that SEBI will also consider mandating, beginning with large Corporates, to meet about one-fourth of their financing needs from the bond market.
  - This will lead to deepening and widening of the bond market as more players gain access to credit with better price discovery mechanism; while reducing burden of providing long term capital on the banking industry.
- Strong regional rural banks to raise capital from the market, which will help them lend to rural economy and exploit business potential.
- The Government will establish a unified authority for regulating all financial services in International Financial Service Centre (IFSCs) in India to fully develop and compete with other offshore financial centres.
- Hybrid instruments are suitable for attracting foreign investments in several niche areas, especially for the startups and venture capital firms. The Government will evolve a separate policy for the hybrid instruments leading inflow of long term capital.

- Agriculture commodities – For better price discovery, Government will create an institutional mechanism, with participation of all concerned Ministries, to develop appropriate policies and practices for price and demand forecast, use of futures and options market, expansion of warehouse depository system and to take decisions about specific exports and imports related measures.
  - Commodity exchanges will see a boost in activities in the agriculture related products with the government aiming to develop policies to help farmers take calculated decision bases price and demand forecasts.
- Government will formulate a comprehensive Gold Policy to develop gold as an asset class and establish a system of consumer friendly and trade efficient system of regulated gold exchanges in the country. Gold Monetisation Scheme will be revamped to enable people to open a hassle-free Gold Deposit Account.
  - These measures are aimed at channelising huge idle Indian gold deposits with households into productive investments through financial intermediation
- Strengthen the environment for growth of VCs and successful operation of alternative investment funds
  - Venture Capital Funds and Alternate Investment Funds will take advantage of policies under ''Start-Up India'' programme to strengthen the environment for their growth. This will also attract higher foreign investments in this category.
- Finance major infrastructure projects both for economic and social growth –
  - Infrastructure based funds will witness further growth due to focus of the government towards utilising these funds for building affordable housing, transport and educational and health infrastructure. Additionally, further boost will come to the equity market with NHAI tapping equity markets to raise funds for mature road projects.
- Ministry of Finance will leverage the India Infrastructure Finance Corporation Limited (IIFCL) to help finance major infrastructure projects, including investments in educational and health infrastructure, on strategic and larger societal benefit considerations.
- The Government introduced Exchange Traded Fund Bharat-22 to raise INR14,500 crore, which was over-subscribed in all segments. Department of Investment and Public Asset Management (DIPAM) will come up with more ETF offers including debt ETF.
  - Through ETFs, the Government divests multiple stocks/bonds spread across various sectors in one bundled instrument and maximizes sale proceed. This benefits the long-term and retail investors by providing an opportunity for participation in equity stocks or debt of the Government run companies.
- The Government and market regulators have taken necessary measures for development of monetizing vehicles like Infrastructure Investment Trust (InvIT) and Real Investment Trust (ReITs) in India. The Government would initiate monetizing select CPSE assets using InvITs from next year.
- Other Regulatory changes - Procedures under various securities laws being strengthened including levy of penalties to deal with various violations. Outward Direct Investment Policy to be reviewed. To manage excess liquidity in banks and others, framework being put in place for an uncollateralized deposit facility with the Central Bank.

Key announcements

Tax

General tax provisions

- Withdrawal of exemption for long-term capital gains on listed equities and units of equity oriented mutual funds and InVITs/REIT's
  - Such gains exceeding INR100,000 to be taxed at concessional rate of 10 percent (plus surcharge and cess), provided the acquisition/ transfer is subject to Securities Transaction Tax (STT), as applicable. No indexation benefit available.
  - Grandfathering/ relief provided in computation of cost of acquisition (CoA) for shares/units acquired before 1 February 2018 such that COA to be considered the higher of –
    - Actual COA of the shares/units and

- Lower of
  - FMV* of the shares/unit and
  - Redemption value/Sale consideration on transfer of the units

  *FMV is defined as:
  - the highest price quoted for the share/unit on 31 January 2018 on a recognized stock exchange or
  - NAV of the unit as on 31 January 2018 where unit is not listed.

- Concessional tax of 10 per cent on long-term capital gains to also apply to Foreign Portfolio Investors (FPIs).
- Equity Oriented Funds now liable to pay dividend distribution tax at 10 percent (plus gross up, plus surcharge and cess)
  - Definition of 'Equity Oriented Fund' expanded to cover 'Fund of Funds' schemes where such 'Fund of Funds' invests in the units of Exchange Traded Fund (ETF), such that:
    - Minimum 90 per cent of total proceeds of such Fund of Funds is invested in the units of ETF and
    - The ETF invests minimum 90 percent of its proceeds in listed equity shares.
- IFSC tax concessions - to promote trade in stock exchanges located in IFSC:
  - Transactions in Bonds/Global Depository Receipts/ Rupee Denominated Bond of Indian companies or Derivatives on recognised exchanges in foreign currency between non-residents not to be regarded as 'transfer'
  - Condition relating to payment of STT not applicable for concessional long term capital gains tax.
- Tax reliefs allowed in relation to companies under the proceedings of Insolvency and Bankruptcy Code, 2016:
  - the aggregate amount of unabsorbed depreciation and loss brought forward allowed to be deducted in computing MAT
  - Restriction on carry forward of tax losses upon substantial change in shareholding not to apply, subject to reasonable opportunity given to income-tax department to present its case.
- Penalties for delays in filing of Annual Information Reports or reports under FATCA and CRS increased from present levels of INR100/INR500 per day to INR500/1000 per day.

Other tax announcements

- Concessional tax rate of 25 percent for companies with turnover of less than INR250 crore in FY2016-17.
- Reduction in Alternate Minimum Tax (AMT) (in case of non-corporate assessee) for a unit in IFSC from 18.5 per cent to 9 per cent (plus surcharge and cess).
- Proposal to levy cess on tax plus surcharge at 4 per cent instead of existing 3 per cent.
- PAN applicable to non-individual entities entering into any financial transaction aggregating to INR250,000 or more in a financial year. Any person acting on behalf of such entities to also apply for PAN.
- Receipt of any property by a wholly-owned Indian subsidiary from its holding company and vice versa to be tax exempt.
- Clarification on treatment on conversion of stock in trade into capital asset – taxable as capital gains.
- Key provisions included under Income Computation and Disclosure Standards (ICDS) now to find place in the law w.e.f. 1 April 2017 to regularise compliance with the ICDS.
- In line with the Multilateral Instrument and also given the highly evolved digitised global environment, provisions to tax overseas enterprises in India being expanded in scope.
- Threshold for tax free interest income for senior citizens from bank and post office deposits increased to INR50,000 from current levels of INR10,000. No withholding on such income.
- Scope of commodities transactions tax being expanded to cover options in commodity derivatives.
- Clarification to exclude trading in agricultural commodity derivatives from 'speculative transactions', despite these not being subject to commodities transaction tax.

Transfer pricing announcements

- Revision of time limit for filing Country-by-Country Report (CbCR) by a Parent or alternative reporting entity (ARE) residents in India.
- CbCR to be filed in India in case overseas Parent entity has no obligation to file CbCR and Parent entity has not nominated ARE.

Our view

- The proposal to withdraw tax exemption for long-term capital gains for the equity market segment and equity mutual funds and units of INViTs/REIT's is no surprise. This is expected to adversely impact investor sentiment and market growth. This move comes with a relief in the gain computation methodology for securities acquired before 1 February 2018 (termed by the Finance Minister as 'grandfathering'). While this relief is meant for investors at large, the ability of foreign portfolio investors to claim the relief needs clarity. In a related move, mutual funds have now to pay tax on distribution of dividend in equity oriented schemes.
- Certain advocated reliefs claimed for companies under insolvency/ bankruptcy proceedings – namely, relief from MAT and from impairment of carry forward losses upon change of shareholding, have come through. Tax relief for non-residents trading in stock exchanges located in IFSC has been welcome move.

Indirect tax

- No major announcements.

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