India Union Budget 2019-20

Point of View

Financial Services

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Key regulatory announcements for the sector

- INR700 billion capital infusion into public sector banks (PSBs) which will also leave money for growth capital
- To ensure continuous PSB funding to financially sound NBFCs, for purchase of high-rated pooled assets amounting to a total of INR1,000 billion during the current financial year, the Government will provide one time six months' partial credit guarantee to PSBs for first loss of up to 10 per cent
- Reserve Bank of India (RBI) will now regulate the housing finance companies (HFCs), which will free up the National Housing Bank (NHB) to focus purely on lending and refinancing
- To allow NBFCs to raise funds in public issues, the requirement of creating a Debenture Redemption Reserve (DRR), which is currently applicable for only public issues, has been done away with
- Deposit-taking and systemically important non-deposit taking NBFCs can now pay tax in the year they receive interest for certain bad or doubtful debts
- Proposed to permit investments made by FIIs/FPIs in debt securities issued by Infrastructure Debt Fund – Non-Bank Finance Companies (IDF-NBFCs) to be transferred/sold to any domestic investor within the specified lock-in period
- A proposal is put forth to rationalise and streamline the existing Know Your Customer (KYC) norms for FPIs to make it more investor-friendly
- AA-rated bonds will be used as collateral in tri-party repo market in corporate debt securities after stock exchanges are enabled by regulators and Government
- Credit Guarantee Enhancement Corporation will be set up in 2019-20 to deepen markets for long-term bonds with specific focus on infra sector for lower cost financing. An action plan to deepen the market for long term bonds including for deepening markets for corporate bond repos, credit default swaps etc., with specific focus on infrastructure sector, will be put in place
- Post amendment in the Factoring Regulation Act, 2011 all NBFCs will be allowed to directly participate on the Trade Receivables electronic Discount System (TReDS) platform, resulting in online financing of trade receivables and reduction in working capital needs
- Focus on bringing micro, small and medium enterprises (MSMEs) under the formal economy's fold
  - Allocation of INR3,500 million for Interest Subvention Scheme for GST-registered MSMEs
  - A dedicated payment platform for the MSMEs to be set up
  - An introduction of a pension scheme for 30 million small traders, recognising the plight of shopkeepers, small traders

- Proposed 100 per cent Foreign Direct Investment (FDI) for insurance intermediaries and suggestions for further opening up of FDI in insurance sector to be examined in consultation with all stakeholders
- Proposal to reduce the net-owned fund requirement to join International Financial Services Centre (IFSC) from INR50 billion to INR10 billion. This would facilitate on-shoring of international insurance transactions and enable the opening of branches by foreign reinsurers in the IFSC
- Proposal for Securities and Exchange Board of India (SEBI) to consider increasing the minimum public shareholding in listed firms to 35 per cent from 25 per cent, which is aimed at increasing liquidity in the stock markets and reduce share price manipulation
- NRI portfolio route to be merged with Foreign Portfolio Investors (FPIs) for seamless investment in stock markets in a move to attract more foreign funds into the Indian market. FPIs will be permitted to subscribe to listed debt securities issued by Real estate investment trust (ReITs) and Infrastructure Investment Trusts (InvITs). Statutory limit for FPI investment in a company proposed to be increased from 24 per cent to sectoral foreign investment limit
- Bringing Central Public Sector Enterprises (CPSE) Equity Linked Savings Schemes (ELSSs)in line with equity-linked savings schemes (ELSS) of mutual funds to encourage retail investors
- Government will offer an investment option in Exchange-Traded Funds (ETFs) on the lines of Equity Linked Savings Scheme (ELSS) that would also encourage long term investment in Central Public Sector Enterprises (CPSEs)
- Idea of social stock exchanges was floated for listing of social enterprises and voluntary organisations working for the realisation of a social welfare objective so that they can raise capital as equity, debt or as units like a mutual fund
- The Government would start raising a part of its gross borrowing programme in external markets in external currencies to access funds at lower cost
- To develop IFSC as aircraft financing and leasing hub - regulatory roadmap to be implemented.

Implications for the sector

The Government is focusing on bringing financial reforms to help fundamentally strong market participants access capital from well capitalised lenders and through efficient domestic capital markets.

- The recapitalisation of INR700 billion for public sector banks would help to bolster the capital base of the banks and reignite credit growth in the economy
- The move to incentivise banks for buying NBFC assets would restore liquidity in NBFCs and push banks to buy assets from them under the pool purchase programme
- Steps have been taken through tax measures to bring deposit- taking NBFCs and systemically important non-deposit taking NBFCs at par with banks and other public financial institutions
- Measures to support financially sound NBFCs and higher regulatory RBI monitoring will lead to drive for consolidation of NBFCs
- Participation of FPI and FDI in the bond market is expected to ease liquidity for NBFCs
- Return of the regulatory authority over HFCs from the NHB to the RBI would aim at an efficient and conducive regulation of the housing sector
- The tri-partite repo market provides opportunity to borrow against securities and provides short-term liquidity to participants
- 100 percent FDI in insurance intermediaries will help in building distribution scale and penetration of insurance. This may also in result strong alternate distribution channel in addition to bancassurance

Key tax announcements for the sector

Banks, NBFCs, stressed assets

- Deposit-taking NBFCs and systemically important non-deposit taking NBFCs now at par with banks - income on non-performing assets to be taxed on receipt basis, defaulting borrowers dis-incentivised
- Boost for distressed companies under purview of NCLT: the condition of continuity of shareholding so as to allow carry forward and set off business losses not to apply; in computing MAT, aggregate of losses and unabsorbed depreciation to be considered
- Fair valuation may not apply to transfers of shares approved by relevant authorities
- Increased tax deduction on interest payouts for borrowers of affordable housing projects

Funds, capital markets, insurance, pensions

- Proposal to not tax the excess consideration received from AIF-Cat II by venture capital undertakings for issue of shares – Cat II AIF brought at par with AIF-Cat I
- New scheme for pass through of losses (other than business loss) in CAT I and II AIF to investors
- To encourage management of offshore funds from India, relaxation of conditions for safe harbour – extended time limit for the Fund to build minimum corpus of INR1 billion; proposal to introduce safe harbour rules relating to remuneration of the Indian fund manager
- Concessional tax rate of STCG to apply to fund of funds set up for disinvestment of Central Public Sector Enterprises (CPSEs)
- To rationalise levy of STT when option is exercised, value of taxable securities transaction based on intrinsic value (difference between strike price and settlement price)
- Withholding on the income component of the life insurance payout to be at 5 per cent on net basis (net of premium) instead of 1 per cent on gross basis
- Anti-avoidance tax measure - listed companies to pay buyback tax; income exempt for shareholder
- Tax free withdrawal from National Pension System (NPS) on closure /opting out, enhanced to 60 per cent from 40 per cent

IFSC

Units located in IFSC

- Uplifted tax holiday scheme for units (now 100 per cent holiday for 10 years with flexibility to choose any 10 consecutive years out of first 15 years)
- Tax exemption for interest paid on external borrowings by units
- For companies in IFSC, exemption from DDT even if dividend paid out of accumulated profits

Trades and investments through IFSC

- Scope of securities eligible for tax exempt transfer being expanded and this will also include securities held by Category III AIF
- Distribution tax removed for mutual funds relocating to IFSC

General

- Further increase in effective taxes for the super-rich (incomes above INR20 million) – can also impact non-corporate FPIs

- Increase in threshold for companies eligible to claim lower tax rate of 25 per cent - from INR2.5 billion to INR4 billion
- Extension of various incentives and more relaxations for start-ups
- Inter-changeability of PAN and Aadhaar proposed for ease of compliance and as a measure of widening the tax base
- Tax measures to discourage large cash withdrawal from banks, measures to promote digital payments, widening of domestic tax information reporting with more penalties
- Condition for tax neutrality for demerger transactions eased for Ind-AS compliant companies.

Indirect tax

- Simplified compliances – simplification of return, automated refund module, e-invoicing system
- Rationalisation in levy of interest (net tax payout basis), fungibility in electronic cash ledger through intra-head transfer
- National Anti-Profiteering Authority empowered to levy 10 per cent penalty on profiteered amount
- Formation of National Appellate Advance Ruling Authority proposed
- Amnesty scheme to resolve pre-GST regime disputes
- Stringent penalties for fraudulent procurement of duty scrips under Foreign Trade Policy; offence to be cognisable and nonbailable where duty exceeds INR5 million
- Import duty for gold hiked from 10 per cent to 12.5 per cent.

To summarise

The current Government aspires to turn India into a USD5 trillion dollar economy in a few years, and the key thrust is on development of the ecosystem towards that objective. In that direction, the tax proposals are aimed at simplification, ease of business and moving towards less cash economy.

The Government has kept its promise to reduce corporate tax rates, which should go a long way in promoting investment. The Budget has met certain long pending demands of industry, especially for start-ups, NBFCs and AIFs. Current tax incentives available to Indian IFSCs have been revitalised keeping in mind the need to improve the competitiveness of Indian IFSCs in the international arena. There are also several measures for rationalisation of cash payments and transaction reporting aimed at containing tax evasion.

Overall, the maiden budget of the current Government has addressed key sectoral demands at this point, while one will also watch out for further changes in the tax system in the upcoming new Direct tax Code.

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