



## Union Budget 2020 Financial Services



### Banking and Capital Markets

#### Policy announcements

##### Banking

- Budget 2020 proposes an enhanced DICGC deposit insurance cover for bank deposits (i.e., both principal and interest). The existing cover of INR 0.1 million (US\$ 0.0014 million) per depositor is proposed to be increased to INR 0.5 million (US\$ 0.0070 million) per depositor.
- With a view to strengthening co-operative banks, it is proposed to amend the Banking Regulation Act to increase professionalism, provide access of capital, and improve governance and oversight for sound banking. These measures are also expected to aid in streamlining the existing multi-regulatory framework (of RBI, Registrar of Societies, and state governments) under which co-operative banks operate.



- To address working capital needs of MSMEs, Budget 2020 proposes to permit banks to extend subordinated debt to entrepreneurs of MSMEs. Such subordinated debt will be considered quasi-equity to ensure that it is fully guaranteed under the Credit Guarantee Trust for medium and small entrepreneurs.

## **NBFCs**

- Only NBFCs with an asset size of INR 5,000 million (about US\$ 70.07 million) or more were allowed to exercise the right of recovery of dues under the provisions of the SARFAESI Act, for a sum of INR 10 million (about US\$ 0.14 million) and above. Budget 2020 proposes to reduce these thresholds and extend aforesaid relief to small NBFCs with an asset size of over INR 1,000 million (about US\$ 14.08 million) for a loan size of INR 5 million or more (about US\$ 0.070 million).
- TReDS is an electronic platform for facilitating the financing/discounting of trade receivables of MSMEs through multiple financiers. To enhance economic and financial sustainability, NBFCs have been permitted to extend invoice financing to MSMEs through the TReDS platform.
- To address liquidity constraints of NBFCs/HFCs, the government had recently formulated a Partial Credit Guarantee scheme. Union Budget 2020 proposes to devise a mechanism to further supplement this liquidity support.
- Budget 2020 also proposes to expand the NABARD re-finance scheme for NBFCs that are active in the agriculture credit space.

## **Capital markets**

- To increase the flow of capital into the country, it is proposed to permit non-residents to implement investments in certain specified categories of government securities that were open only to domestic investors.
- To further deepen the bond market, it is proposed to increase the current limit of FPI investment in corporate bonds from 9% to 15% of the outstanding stock of corporate bonds.
- On the heels of the success of the recently floated Debt ETF, i.e., “Bharat Bond ETF”, it is proposed to float a new Debt-ETF consisting primarily of government securities. The constitution of the new Debt-ETF is likely to serve as an attractive investment avenue for retail investors, pension funds, and long-term investors, as well as help in further widening the G-sec market.

- With a view to improve investor confidence and expand the scope of credit default swaps, it is proposed to introduce a new legislation to provide for netting of financial contracts. This scheme will also aid in strengthening the Indian derivatives market.
- Given the need for greater private capital access to the banking system, it is proposed to divest the government's stake in IDBI Bank to private, retail, and institutional investors through the Indian capital markets.
- With an objective of inculcating corporate discipline, providing access to financial markets, and according an opportunity to unlock economic value, the government has proposed to divest a part of its holding in LIC by way of an Initial Public Offer.
- It is also proposed to set-up an International Bullion Exchange in the IFSC-GIFT City, as an additional option for trade by global market participants.

## Direct tax proposals

- With a view to address challenges that amalgamated public sector banks will face (in light of the proposed merger of 10 public sector banks into 4 public sector banks), Budget 2020 proposes to allow the resulting public sector banks to carry forward and set off losses and unabsorbed depreciation of the amalgamating public sector banks, provided the proposed amalgamation is under the scheme framed by the government under section 45(7) of the Banking Regulation Act, 1949 or section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act of 1970 and / or 1980. The amendment will come into effect from assessment year 2020-21.
- Budget 2020 proposes to amend the thin capitalisation rules to provide that the interest limitations that are contained in section 94B of the Act will not apply to interest paid in respect of a debt issued by the Indian bank branch of a foreign bank to its customers. The amendment will come into effect from assessment year 2021-22.
- To widen and deepen the tax net, it is proposed that an authorised dealer receiving an amount of INR 0.7 million (US\$ 0.0098 million) or more, in a financial year for remittance out of India under the Liberalized Remittance Scheme of RBI shall collect TCS at the rate of 5% (10% if the remitter does not have a PAN/Aadhar). The amendment will come into effect from 01 April 2020.
- The concessional tax rate of 5% for interest received by non-residents from foreign currency borrowings made to an Indian company or a business trust, or rupee denominated bond issuances made by an Indian company or a business trust, has been extended from 30 June 2020 to 30 June 2023.

- With a view to incentivise listing of bonds on the IFSC stock exchange, Budget 2020 proposes to further reduce the concessional tax rate for interest income from 5% to 4%, in respect of interest paid on monies borrowed in foreign currency from a source outside India by way of issuance of any long-term bonds or rupee denominated bonds listed on the stock exchange located in any IFSC and issued on or after 01 April 2020 but up to 30 June 2023. The amendment will come into effect from 01 April 2020.
- Given the changes in the commodity derivative markets, and to encourage commodity transactions, settled by physical or actual delivery of goods, it is proposed to charge CTT on new commodity derivative products at the prescribed rates tabulated below. The amendment will come into effect from

Particulars	Rate of CTT
Sale of commodity derivative based on prices or indices of prices of commodity derivative	0.0001% payable by the seller, which is the same rate at which CTT is currently charged on sale of commodity derivative
Sale of an option in goods, where option is exercised resulting in actual delivery of goods	0.0001% payable by the purchaser
Sale of an option in goods, where option is exercised resulting in a settlement otherwise than by the actual delivery of goods	0.125% payable by the purchaser, which is the same rate at which securities transaction tax (STT) is levied on sale of an option in securities, where the option is exercised

- Starting 1 April 2020, dividends declared by Indian companies will be taxable in the hands of the recipient shareholders at the respective tax rates applicable to shareholders. The Indian company will be required to withhold tax on dividend at the following rates:

Particulars	Tax rate (excluding surcharge and health and education cess)
Dividends paid to resident shareholders, exceeding INR 5,000	10%
Dividends paid to non-resident shareholders, including NRIs	20% or the applicable tax treaty rate
Dividend paid to FPIs	20%
Dividends paid on GDRs / ADRs	10%

- To ensure that there is no cascading impact of multi-layered shareholding structures, domestic companies will be entitled to a tax deduction for dividends received from other domestic companies, to the extent of dividends distributed by the recipient domestic company up to one month before the income-tax return filing due date for the recipient domestic company.
- Shareholders will not be entitled to claim a tax deduction for expenses incurred to earn such dividend income, other than a tax deduction for interest expense which is to be capped at 20% of the dividend income.
- Starting 1 April 2020, income distributed by an Indian mutual fund will be taxable in the hands of its unit holders at the respective tax rates that are applicable to the unit holders. The Indian mutual fund will be required to withhold tax on the income distributed at the following rates:

Particulars	Tax rate (excluding surcharge, and health and education cess)
Income distributed to resident unitholders, exceeds INR 5,000	10%
Income distributed to non-resident unitholders, including NRIs	20%
Income distributed to FPIs that are unitholders	20%

- Dividend stripping provisions contained in the Act will become redundant starting 1 April 2020.

### Indirect tax proposals

- Exemption from payment of Social Welfare Surcharge on import of ATM machines, has been withdrawn.



## Investment Management

### Direct tax proposals

#### FPIs

- The concessional tax rate of 5% granted to FPIs on interest earned on qualifying rupee denominated bonds and government securities has been extended from 30 June 2020 to 30 June 2023.
- The above concessional tax rate of 5% is proposed to be extended to FPIs on interest that they earn on municipal debt securities.
- Starting AY 2020-21, Budget 2020 proposes to extend the carve-out from the applicability of indirect transfer provisions that is provided to non-resident investors in FPIs that were regarded as Category 1 and Category 2 FPIs under the erstwhile SEBI (FPI) Regulations, 2014, even after the repeal of the aforesaid regulations.
- Starting AY 2020-21, Budget 2020 proposes to extend the carve-out from the applicability of indirect transfer provisions that is provided to non-resident investors in FPIs that get registered with SEBI as Category I FPIs under the SEBI (FPI) Regulations, 2019.
- Starting 1 April 2020, FPIs will be taxable in India on the dividend income they earn from their investments in shares of Indian companies, at the tax rate of 20% or applicable tax treaty rate. Indian companies will be required to withhold tax at 20% on the dividends they pay to FPIs. The FPIs will need to claim credit for such taxes withheld by the Indian companies in their respective home countries, in accordance with the laws of their respective home countries.
- Starting 1 April 2020, FPIs will be taxable in India on the income distribution they earn from their investments in units of Indian mutual funds at the rate of 20 percent or applicable tax treaty rates. Indian mutual funds will be required to withhold tax at the rate of 20 percent on the income that they distribute to the unit holders that are FPIs. FPIs will need to claim credit for taxes withheld by such Indian mutual funds in their respective home countries in accordance with the laws of their respective home countries.
- Non corporate FPIs (e.g., business trusts, firms, etc.) will now be permitted to pursue tax matters before the Dispute Resolution Panel.

- The due date for filing income-tax returns for corporate tax payers (including FPIs) that do not have any Indian transfer pricing implications is proposed to be extended from September 30 (following the close of the Indian financial year) to October 31 (following the close of the Indian financial year).

## **Sovereign wealth funds**

- Starting 1 April 2020, (1) sovereign wealth funds, which satisfy prescribed conditions and are notified by the Central Government, and (2) any wholly owned subsidiary of ADIA, which is a resident of the UAE and makes investments directly/indirectly out of funds owned by the government of the UAE, shall be tax exempt in India on any dividends, interests, and long-term capital gains realised from an investment made in India, whether in the form of debt or equity. This is subject to the investment satisfying the following conditions:
  1. It is made on or before 31 March 2024.
  2. It is held for at least 3 years.
  3. It is in a company/enterprise carrying on the business of developing, or operating and maintaining, or developing, operating, and maintaining any infrastructure facility defined in Explanation to clause (i) of section 80-IA(4), or such other business as may be notified by the Central Government.

## **Mutual funds**

- Indian mutual funds are now required to withhold tax on income distributed to their unit holders at the tax rates prescribed.
- In December 2018, SEBI permitted mutual fund schemes to create segregated portfolios of debt and money market instruments. Budget 2020 contains proposals that streamline the tax treatment for unit holders where such side-pocketing occurs.
  1. Unit holders will be entitled to include the period of holding of units in the main portfolio (before segregation) for determining the period of holding of the segregated portfolio.
  2. The cost basis of unit holders in the total portfolio will be bifurcated between the main portfolio and the segregated portfolio in the ratio of NAV of the assets retained/transferred to the total NAV.
  3. This amendment will come into effect from assessment year 2020-21.

## **REITs / InVITs**

- As a consequence of the proposed abolition of the DDT regime, there are significant amendments to the business trust taxation regime with respect to dividend taxation. Dividends earned by business trust from its portfolio companies and flowed back to its unit holders will now be taxable in the hands of unit holders at the tax rates that are applicable to unit holders. The business trust will need to withhold tax at 10% on the aforesaid dividends that flows back to its units holders.
- With the intention of according private unlisted InvITs the same tax treatment as public listed InvITs, the definition of 'business trust', provided in section 2(13A) of the Act, is being suitably modified to do away with the requirement of the units of a business trust to be listed on a recognised stock exchange in India.

## **India-based fund manager regime**

- In the context of the India-based fund manager tax regime, Budget 2020 proposes to relax the following two criteria for eligible investment funds:
  1. For the first three years of operation of the fund, any contribution by the eligible fund manager in India in an eligible investment fund up to INR 250 million (approximately US\$ 3.5 million), will not be counted towards the cap of 5% for direct or indirect resident investment in the eligible investment fund.
  2. Where the eligible investment fund has been established or incorporated in a particular financial year, it will have an enhanced timeline of 12 months from the last day of the month of its establishment or incorporation to satisfy the condition of monthly average corpus of INR 1,000 million (approximately US\$ 14.08 million).





### Direct tax proposals

#### **Restriction cost of acquisition of immovable property to stamp duty value as on 01 April 2001**

Under the existing provisions, in case of property acquired before 01 April 2001, the fair market value, as on 01 April 2001, could be taken to be the cost of acquisition of immovable property. However, it has now been pegged to stamp duty value, as on 01 April 2001.

#### **Increase in safe harbor limit of 5% under section 43CA, 50C and 56**

- The said sections currently provide a tolerance limit of 5% of consideration received up to which the difference between stamp duty value and value of consideration paid/received on transfer of an immovable property shall not be taxable. The amendment proposes to increase the tolerance limit to 10%.

#### **Extension of time limit of approval for deduction for affordable housing projects under section 80 IBA**

- The extension of period of approval of the housing project by the competent authority from 31 March 2020 to 31 March 2021 for the purpose of availing the benefit of a 100% deduction of the amount of profits and gains from affordable housing projects

#### **Deduction in respect of interest on loan availed on affordable houses**

- Extension of period of sanctioning of loan from 31 March 2020 to 31 March 2021 availed from a financial institution to acquire an affordable residential house property for the purpose of deduction of interest on such loans.

### Indirect tax proposals

- Exemption granted from payment of social welfare surcharge on import of specified goods used for construction that includes marble, tiles, cubes, marble blocks/tiles, and marble monumental stone.



### Direct tax proposals

- Non-life insurance companies are liable to tax on their book profits computed in accordance with the provisions of the Insurance Act, 1938 and related rules. However, they are required to disallow expenditures that are not admissible under sections 30 to 43B of the Act. Budget 2020 proposes to allow such insurance companies a tax deduction for amounts disallowed under section 43B in a previous financial year (on the basis that such amounts had not actually been paid) in the year in which the insurance company actually pays them.
- To alleviate issues faced by amalgamated public sector general insurance companies, Budget 2020 proposes to allow the resulting government company to carry forward and set-off losses, and unabsorbed depreciation of the amalgamating government company, if the merger is in accordance with a scheme sanctioned and brought into force by the Central Government under section 16 of the General Insurance Business (Nationalisation) Act, 1971.
- While Budget 2020 proposes to tax dividends in the hands of recipient shareholders (by abolishing the dividend distribution tax) and cast an obligation to withhold tax at 10% on distributing domestic companies, the aforesaid withholding will not apply to dividends credited or paid to the Life Insurance Corporation of India, the General Insurance Corporation of India, National Insurance Company Limited, New India Assurance Company Limited, Oriental Insurance Company Limited, and United India Insurance Company or any other insurer in respect of any shares owned by them or in which they have full beneficial interest.