



Financial Services

Union Budget 2017-18

**Post-Budget sectoral
point of view**

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Setting the context

Where are we

The financial services sector in India is shaping up dynamically with a range of government and regulatory measures announced over the last year. Let's examine how the financial services industry has developed in the recent past.

Banking overview¹

- Aggregate deposits in the banking system: INR90.3 lakh crores (9.3 per cent Y-o-Y growth) (FY16)
- Gross bank credit: INR66.5 lakh crore (10.9 per cent Y-o-Y growth) (FY16)
 - The housing credit is up 4.4 per cent while the micro credit has gone down 4.5 per cent as on December 2016
- Credit-deposit ratio: marginally up from 52.3 per cent to 53.4 per cent in FY16.

Key issues/challenges

- Lower credit growth (negative 0.8 per cent in FY17 until December as per the RBI)
- Need for credit offtake to utilise the high deposit base for maintaining the capital adequacy ratio
- Demonetisation led lower cost of funds
- High Non Performing Asset (NPA) levels of PSU banks amounting to INR4.8 lakh crore (FY16 as GNPA)

Source: "Refer all high-value NPA resolution cases to overseeing committee", Business Standard, http://www.business-standard.com/article/finance/refer-all-high-value-npa-resolution-cases-to-overseeing-committee-finance-ministry-to-psbs-116101600161_1.html, accessed on 31 January 2017; KPMG in India's analysis 2017

Non Banking Financial Companies (NBFC) overview²

- The NBFC space has shown good growth compared to the banking sector over the past few years
 - Retail Asset Under Management (AUM): INR4.2 lakh crore in FY15 and estimated to be INR6.1 lakh crore in FY17
- The fast-paced growth in credit disbursement by NBFCs was due to their ability to mitigate risks and cater to demand in niche markets. The profitability of NBFCs was also significantly higher than the commercial banks
- The banking credit industry growth rate fell to a 20-year low of 8.6 per cent in June 2015 while NBFCs expanded at 18.8 per cent year-on-year during the nine-month period ending December 2015.

Key issues/challenges

- High overhead and compliance costs led by the collection of TDS certificates from customers
- Non availability of Sec43D benefits negatively affecting cash flows due to taxes on sticky advances, irrespective of receipts

Source: "FICCI pre-budget memorandum", FICCI, January 2017

Insurance overview

- In the last few years, the insurance sector has witnessed a series of regulations. These include enhancing the Foreign Direct Investment (FDI) limits, formulating listing norms for general insurance companies, issuing entry licences to global reinsurers and launching the 'Pradhan Mantri' series of schemes aiming at financial inclusion

¹ RBI bulletin, RBI, January 2017

² "Opportunity aplenty for NBFC sector", Business Line, <http://www.thehindubusinessline.com/portfolio/macro-view/opportunity-aplenty-for-nbfc-sector/article8748805.ece>, accessed on 31 January 2017

- Average premium growth: 7.9 per cent³ as against 9.8 per cent³ for the emerging economies (FY16)
- Premium underwritten for life insurance: INR50,979 crores (8.43 per cent Y-o-Y growth) (FY16)³
- Gross direct premium income for non-life insurance: INR96,380 crores (13.81 per cent Y-o-Y growth) (FY16) (share of major sub segments - motor insurance : 43.89 per cent and health insurance: 28.49 per cent)³
- Insurance penetration: 3.44 per cent³ vs 6.2 per cent⁴ world average (FY16)
- Protection gap: 92.2⁵ per cent (FY15)
 - Only 20 per cent population under health insurance (FY15)⁶
 - Insignificant 0.07 per cent property insurance penetration (FY15)⁷
 - About 60 per cent uninsured motor vehicles on the roads (FY16).⁸

Key issues/challenges

- Low insurance penetration
- Lack of awareness and returns-oriented mindset
- Inadequate ratio of government expenditure on healthcare: 30 per cent vs 56 per cent in China
- Need for trained agents and distributor networks to curb misselling and develop a long term association agenda

Source: "India's healthcare spend remains dismal; why budget should focus on better utilisation of resources", <http://www.firstpost.com/business/indias-healthcare-spend-remains-dismal-why-budget-should-focus-on-better-utilisation-of-resources-3216394.html>, First Post website, accessed on 31 January 2017, KPMG in India's analysis 2017

Mutual funds overview

- Mutual funds have seen an overall growth in the last 10 years
 - Mutual fund asset size: INR13.5 lakh crore (14 per cent Y-o-Y growth) (FY16)⁹
 - Fresh investments: INR2.9 lakh crore in FY16 from INR1.8 lakh crore in FY15¹⁰
 - Mutual fund penetration (AUM to GDP): 7 per cent as against 37 per cent world average (FY15)¹¹
- Distribution via digital mode is fast catching up as a trend. These include plans on e-KYC, integration with wallets and payment platforms for the purchase of mutual funds.

Key issues/challenges

- Low mutual fund penetration
- Lack of awareness and preference for old school modes of investment, such as savings accounts and gold
- High cost of distribution in B-15 locations
- Need for strategic partnership formulation such as with payments banks, postal networks, etc
- Need for trained agents and distributors

Source: KPMG in India's analysis 2017

³ IRDAI Annual Report 2015-16, IRDAI, 15 December 2016

⁴ "Insurance penetration at 10-year low", Business Standard, http://www.business-standard.com/article/finance/insurance-penetration-at-a-near-10-year-low-115062401243_1.html, accessed on 31 January 2017

⁵ "India's mortality protection gap at \$92.2 per household: Study", Livemint, <http://www.livemint.com/Politics/PcFbSXjALnpgangWj2MIQjI/Indias-mortality-protection-gap-at-922-per-household-Stu.html>, accessed on 31 January 2017

⁶ "Less than 20% of population under health insurance cover: Report", Times of India, <http://timesofindia.indiatimes.com/india/Less-than-20-of-population-under-health-insurance-cover-Report/articleshow/49082784.cms>, accessed on 31 January 2017

⁷ "Budget 2017 can help increase insurance penetration", Business Today, <http://www.businesstoday.in/union-budget-2017-18/ceo-expectations/budget-2017-can-help-increase-insurance-penetration/story/244880.html>, accessed on 31 January 2017

⁸ "60% of vehicles on Indian roads don't have insurance", Times of India, <http://timesofindia.indiatimes.com/india/60-of-vehicles-on-indian-roads-dont-have-insurance/articleshow/56744325.cms>, accessed on 31 January 2017

⁹ "MF industry's assets grow 14% in FY16", Business Standard, http://www.business-standard.com/article/markets/mf-industry-s-assets-grow-14-in-fy16-116040200373_1.html, accessed on 31 January 2017

¹⁰ "Mutual funds receive Rs2.86 trillion in 2016", Livemint, <http://www.livemint.com/Money/YipPoWcwxMurzJKhGeHPFI/Mutual-funds-receive-Rs286-trillion-in-2016.html>, accessed on 31 January 2017

¹¹ "India has among the lowest MF-GDP ratios globally: Report", The Economic Times, <http://economictimes.indiatimes.com/mf/mf-news/india-has-among-the-lowest-mf-gdp-ratios-globally-report/articleshow/54440169.cms>, accessed on 31 January 2017

Key measures thus far

- In the wake of demonetisation, and with the intention of digitalising the economy, the following steps have been taken in the Budget:
 - Aadhaar Act, 2016 enacted to enable direct benefit transfers to Indian residents through Aadhaar number
 - BHIM (Bharat Interface For Money) application launched to enable smartphone users to make instant payments across different platforms
 - Fees paid on digital transactions (Merchant Discount Rate) reduced from 1 January 2017 to 31 March 2017
 - Idea of Aadhaar Pay conceived – to enable digital payments without using phones or e-wallets
- Goods and Services Tax (GST) implementation from 1 July 2017 remains on schedule
- The Insolvency and Bankruptcy Code has been introduced to facilitate insolvency resolution process and liquidation
- Provisions under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) and Debt Recovery Tribunal Acts also strengthened
- For the first time in its history, the Reserve Bank of India (RBI) to explicitly operate the monetary policy framework. Also, a monetary policy committee constituted that shall determine the policy rate required to achieve the inflation target¹²
- Foreign investments in stock exchange have been raised to 15 per cent; also, the Foreign Portfolio Investors (FPIs) have been allowed to acquire shares through initial allotment in the stock exchanges.
- Limits for the FDI relaxed for several sectors:

Sector	FDI limit (per cent)
Financial sector	
Asset reconstruction companies	100 (Automatic)
Pension fund	49 (Automatic)
Other financial services	100 (Automatic)
Other sectors	
Defence manufacturing	100 (Automatic up to 49 per cent)
PSU petroleum and oil refineries	49 (Automatic)
Telecom	100 (Automatic up to 49 per cent)
Power exchanges	49 (Automatic)

¹² Monetary Policy Report, RBI, 04 October 2016

Key policy proposals

Key announcements and impact

'Transform, Energise and Clean India (TEC India)' has been the stated theme of the Union Budget for 2017–18. In the backdrop of global, political and economic uncertainty and new challenges to globalisation, the Budget highlights India as a bright spot on the global economic map.

The Budget proposes a slew of measures for the government's stated 10 themes of increasing farmer incomes, rural employment, energising the youth, strengthening the underprivileged, infrastructure, growth and stability of financial sector, digital economy, effective governance in public services, prudent fiscal management and tax administration.

The key provisions relevant to the financial services sector are:

Banks, non-banking financial companies, Housing Finance Companies	
Energise India	<ul style="list-style-type: none"> For recapitalisation of banks, INR10,000 crore is allocated in 2017-18, which is expected to help banks to adhere to the capital adequacy requirements in Basel III Listing and trading of security receipts on stock exchanges being enabled to promote securitisation and to help ease the financial system from distressed assets. This can broaden the investor base and bring in more liquidity in the market Tax deduction provided to banks for provisioning towards stressed assets proposed to be increased to 8.5 per cent from 7.5 per cent of the total income. Reduced tax liability would give a breathing space to banks and help increase the flow of funds towards reserves and dividends Provisions allowing taxation of interest from stressed assets on receipt basis extended to cooperative banks would strengthen the financial ecosystem and bring more stability (presently available only to scheduled and unscheduled banks) Cenvat credit provisions amended to provide that banks, financial institutions (including NBFCs) could consider the value of interest earned as exempt income (with effect from 2 February 2017) for availing credit on a pro-rata basis.
Clean India	<ul style="list-style-type: none"> Legislation being introduced to curtail the menace of illicit deposit schemes; this could protect gullible and poor investors from frauds.
Proposals concerning foreign investment	
Transform India	<ul style="list-style-type: none"> The Foreign Investment Promotion Board (FIPB) has been proposed to be abolished in 2017– 18.
Energise India	<ul style="list-style-type: none"> Single Window Clearance — FPI aspirants to seek Securities Exchange Board of India (SEBI) and tax registration, and opening of bank and demat accounts, all through a common application Investors in the Category I and II FPIs to be spared from the rigours of indirect transfer provisions Special taxation regime for off shore funds proposed to be liberalised — maintenance of minimum fund size not necessary in the year of wound up The scheme of concessional 5 per cent withholding tax on foreign sourced debt extended to 30 June 2020. A clarification about the benefit is also available to Rupee Denominated (Masala) Bonds An exemption has been given for capital gains arising on transfer of Rupee Denominated (Masala) Bonds between non-residents (NR). The capital gains tax exemption on the forex gain arising upon the redemption has now been extended to secondary holders A clarification that concessional 10 per cent rate of capital gains tax arising to non-residents on account of transfer of shares of a private limited company is retrospective from the Assessment Year 2013–14.

Insurance	
Energise India	<ul style="list-style-type: none"> To reduce the compliance burden, insurance agents are now being allowed to provide declarations (Form 15G/15H) to receive withholding tax-free commission payments.
Mutual funds	
Energise India	<ul style="list-style-type: none"> Clarity relating to tax neutrality for consolidation of schemes within the mutual fund has been given — historical cost and period of holding of units in consolidating scheme to be factored in. This would ease the capital gains tax computation.
Digitalisation	
Transform India	<ul style="list-style-type: none"> To boost digital payments, threshold for tax disallowance of cash expenses to a person on a single-day decreased to INR10,000 from INR20,000 In order to move to a less-cash dependent economy, the government has proposed to penalise cash receipts of INR300,000 or more from a single person on a single day, or for a single transaction or relating to the same event/occasion To boost Small and Medium Enterprises (SME), the presumptive tax rate for enterprises with a turnover of up to INR2 crores has been reduced to 6 per cent from 8 per cent to the extent that it is through non-cash means To ease affordability, full custom duty exemption provided on import of Miniaturised Point of Sale (POS) card reader for m-POS (not including mobile phones, or tablet computers), micro ATM, fingerprint reader/scanner or iris scanner or parts and components for manufacture of such products, are subjected to actual user condition POS devices and all goods for manufacture of POS devices have been exempted from central excise duty. The exemptions are being extended to 30 June 2017 There is a proposal to create a Payments Regulatory Board in the RBI by replacing the existing Board for Regulation and Supervision of Payment and Settlement Systems.
Generic policies affecting the financial services sector	
Transform India	<ul style="list-style-type: none"> There are plans to enable online registration of financial market intermediaries, such as mutual funds, brokers and portfolio managers. The ease of doing business would drive more market participation from these intermediaries An expert committee would be being set up to conceptualise the framework to integrate spot market and derivatives market for commodities trading. The Electronic-National Agriculture Market (E-NAM) would be an integral part of such a framework, which would help in better price discovery of products for farmers.
Energise India	<ul style="list-style-type: none"> Legislative measures underway to protect consumers and to bring stability and resilience in the Indian financial system.
Some general tax proposals	
Energise India	<ul style="list-style-type: none"> The period for carry forward of Minimum Alternate Tax (MAT) credit extended to 15 years from 10 years. This would allow companies to reduce their tax outflow Aimed at making SME companies more viable, income tax for companies with an annual turnover of up to INR50 crores is proposed to be reduced to 25 per cent (plus surcharge and education cess).¹³ This is expected to fuel credit inflow due to higher credit worthiness For individual assesses, tax on basic income slab of INR2.5 lakhs to INR5 lakhs to be reduced to 5 per cent from 10 per cent. The increased disposable income is likely to benefit the wide strata of taxpayers, and is thus expected to fuel the opportunity to sell personal investment products by banks and other financial services firms A surcharge of 10 per cent on tax payable has been imposed on individuals whose annual taxable income is between INR50 lakhs and INR1 crore
Clean India	<ul style="list-style-type: none"> Provisions relating to computation of book profit for levy of MAT are being aligned with the Indian Accounting Standards.

¹³ Applicable surcharge 7 per cent (for income exceeding INR10 million upto INR100 million) and 12 per cent (for income exceeding INR100 million). Education cess applicable at the rate of 3 per cent. Effective rate ranges from 25.75 per cent to 28.84 per cent.

Revenue boosters

- Thin capitalisation provisions proposed to be introduced – deduction of Indian interest expense on account of overseas associated enterprise proposed to be restricted to 30 per cent of earnings before interest, depreciation and amortisation. Disallowed interest can be carried forward and set-off in the next eight years. These provisions are not applicable to banking and insurance businesses
- Transfer pricing provisions for specified domestic transactions to be diluted – these provisions would apply only for profit-linked deductions
- Secondary adjustment has been introduced – as a result of adjustment to the arm's length price, if there is an increase in the total income or reduction in the loss, the excess money available with its associated enterprise (AE), if not repatriated to India within the prescribed time, will be deemed to be an advance made by the assessee to such AE and interest on such advance will be computed as income of the assessee in the prescribed manner.

Our point of view

- The Budget is directed at furthering the government's commitment to the eradication of black money and expansion of the tax base, extending the digital reform, ease of doing business and simplification in governance. It also aims to give impetus to the sluggishness in manufacturing, exports and capital expenditure and attempts to build a hedge against the possible impact of global uncertainties
- A slew of measures have been proposed to enable skill development and equitable social development, to build better infrastructure, promote SMEs
- Several policies as well as tax measures have been laid down to incentivise digital money transfers and discourage the use of cash. These measures would augur well for the implementation of GST set to kick in from July 2017
- Consideration has been given to de-stressing the banking system from the burden of bad loans. At the same time, the demand of NBFCs for parity in the treatment of income from stressed assets has not been addressed.

Unfinished agenda

In this Budget, the financial services sector has received some small tweaks and perks that would help them operate better. However, a medium to long term road map to combat challenges, which exists for some time now, would definitely help business houses plan better.

What remains

- Exemption of indirect transfer provisions has not been extended to other foreign players, such as FPI Cat III investors, Private Equity, Venture Capital Funds and Alternate Investment Funds
- No significant reduction in tax rates (except corporate tax rate for those with a turnover of up to INR 50 crore)
- No change in MAT and alternate minimum tax (AMT) rates
- General insurance industry has not been exempted from MAT
- No relief in Dividend Distribution Tax (DDT) rate; also, the cascading effect of DDT has not been removed
- The provisions relating to the grossing-up of DDT applicable to debt mutual fund schemes has been retained
- Set-offs and carry forward of losses have not been increased beyond eight years for insurance/reinsurance companies
- No clarity has been provided on taxation of foreign reinsurance companies
- Interest paid to NBFCs has not been excluded from the tax withholding net
- No exemption has been provided from the requirement of withholding tax on distribution of exempt income by AIFs to its resident investors
- Deduction available for provision made against doubtful assets has not been extended to HFCs; also, no tax relief available for deposits placed with HFCs
- No deferment of Income Computation and Disclosure Standards has been announced
- No deduction has been provided for CSR expenditure.

What is expected going forward

- Liberalisation of the FDI policy
- GST – extensive efforts to reach out to trade and industry from 1 April 2017 to create awareness
- Enactment of Arbitration and Conciliation Act, 1996, is to streamline the institutional arrangements for resolution of disputes in infrastructure-related construction contracts, Public-Private Partnership contracts and public utility
- Protocols to address cybersecurity issues
- Amendments to the Payment and Settlement Systems Act, 2007, including the creation of Payments Regulatory Board in the RBI
- Model Shops and Establishment Bill to enhance uniform working conditions across the country and promote other business as well labour-friendly objectives
- Senior citizens to get Aadhaar-based smart cards and also earn 8 per cent interest on savings through the LIC
- Amendment in the Negotiable Instruments Act for better protection against dishonoured cheques
- Scheme for issuance of electoral bonds for political funding.



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