BANKING, FINANCIAL SERVICES, AND INSURANCE

AN INDIA UNION BUDGET UPDATE 2025

Part 1: Business implications

What The Industry Asked For?

- **100% in FDI in the Insurance Sector:**

  The Union Budget 2025 is anticipated to introduce 100% foreign direct investment (FDI) in the insurance sector. This is in alignment with earlier reforms aimed at liberalising the sector. The Finance Ministry had initially proposed this increase in FDI to 100% in November 2024.

- **Enhance credit accessibility for MSMEs:**

  The MSME sector is anticipating the introduction of a dedicated liquidity facility in the Union Budget 2025 to enable easier access to working capital and long-term financing. MSMEs are seeking strengthening of the Credit Guarantee Scheme to ensure seamless access to affordable funding which would help MSMEs reduce their reliance on expensive informal sources.

- **Key expectations of NBFCs:**

  - Increasing refinancing options for NBFCs: The Finance Industry Development Council (FIDC) is advocating for the establishment of a dedicated refinance institution to support NBFCs.
  - Reducing loan size threshold for NBFCs for invoking SARFAESI Act: NBFCs are pushing to lower the loan size threshold for invoking the SARFAESI Act from INR 2mn to INR 0.1mn similar to that of banks and HFCs.

- **Financial inclusion and enhanced access to financial services in under-served areas:**

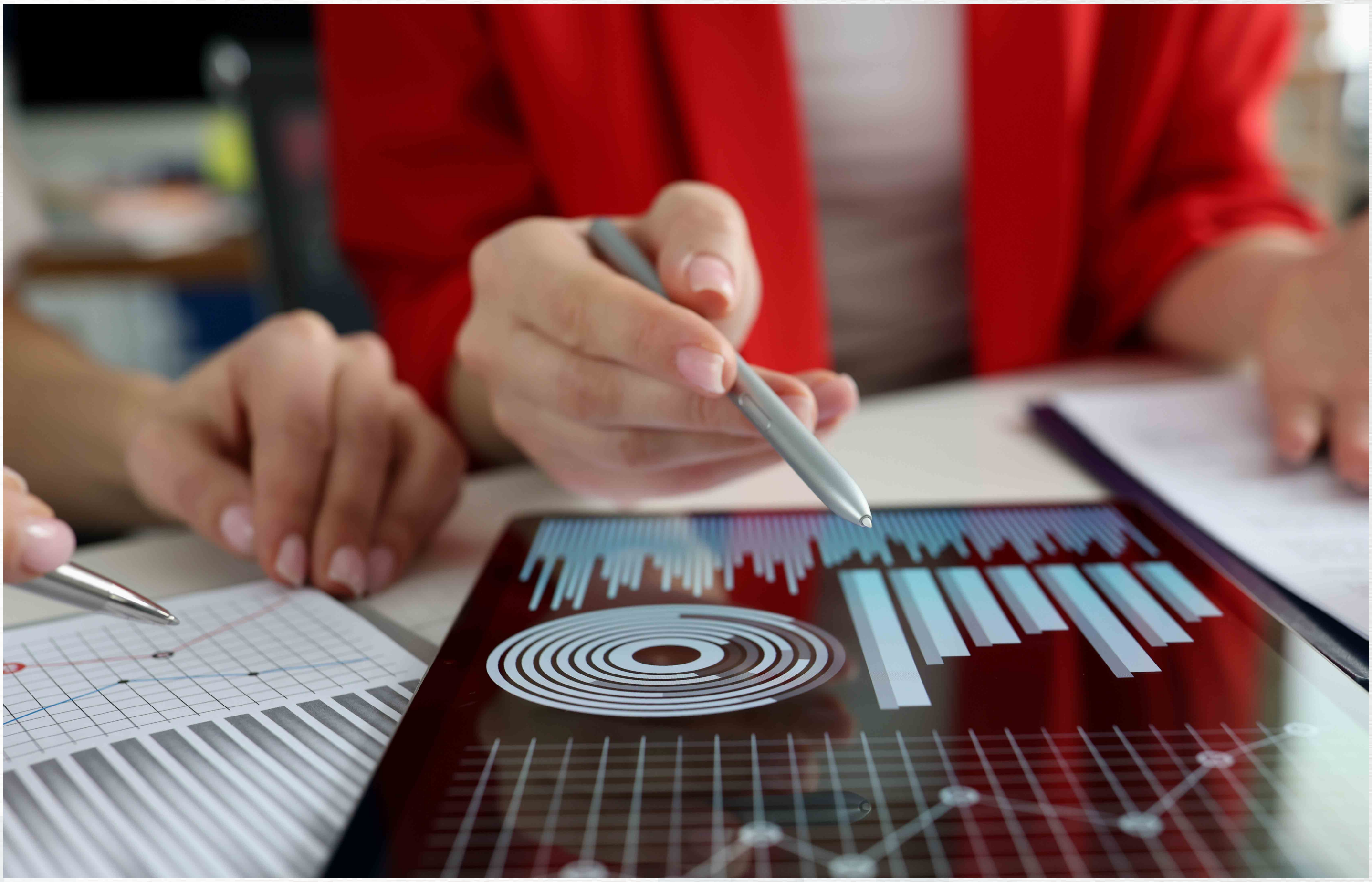
  Fintech companies have called for increased financial inclusion and enhanced credit availability in under-served areas seeking Government funding to improve digital infrastructure and develop tailored financial products. They emphasise the need for expanded microfinance options and partnerships with local institutions to empower under-served communities. Additionally, initiatives to boost financial literacy are essential to ensure effective utilisation of new financial services.

- **Strengthening the Digital Lending Ecosystem:**

  Experts urged improvements to the digital lending ecosystem to enhance credit access, particularly in rural India. Rising credit fraud, limited customer protection, and cyber scams highlight the need for prioritised measures to strengthen digital finance. .

- **Improving the Digital Infrastructure and Regulatory Support:**

  The financial services sector has highlighted the need for enhanced digital infrastructure and regulatory support. Stakeholders are anticipating increased investment in digital infrastructure to boost competitiveness and streamlined regulations to help create a more robust framework for digital transactions.



What Budget Gave?

- **100% in FDI in the Insurance Sector:**
  The Union Budget 2025 announced several key measures to support the MSME sector:
  - **Significant enhancement of credit availability with guarantee cover:**
    - Micro and Small Enterprises: Credit guarantee cover increased from INR 50mn to INR 100mn, adding INR 1,500bn in credit over 5 years.
    - Startups: Guarantee cover raised from INR 100mn to INR 200mn, with a 1% fee for loans in 27 key sectors.
    - Exporter MSMEs: Access to term loans up to INR 200mn for well-performing exporters.
    - Credit Cards for Micro Enterprises: The Union Budget 2025 has introduced customised credit cards with a limit of INR 0.5mn specifically for micro enterprises registered on the Udyam portal, with plans to issue 1mn such cards in the first year.
    - Scheme for first time entrepreneurs: A new scheme will be launched to provide term loans of up to INR 20mn over the next 5 years for 0.5mn first-time entrepreneurs, including women, Scheduled Castes, and Scheduled Tribes.
    - Fund of Funds for Startups: A new Fund of Funds with INR 100bn contribution will be established to expand support for startups, building on previous commitments of over INR 910bn to Alternate Investment Funds (AIFs).

- **Financial inclusion and enhanced credit access to underserved areas:**
  - **Enhanced Credit through Kisan Credit Cards (KCC):** KCC to provide short-term loans to 77 million farmers, fishermen, and dairy farmers. The loan limit under the Modified Interest Subvention Scheme will be increased from INR 0.3mn to INR 0.5mn for KCC loans.
  - **Revamping PM SVANidhi scheme:** The PM SVANidhi scheme which has supported over 6.8 million street vendors by alleviating their reliance on high-interest informal loans will be revamped under the Union Budget 2025. The revamped scheme will offer higher bank loans, UPI-linked credit cards with INR 30,000 limit, and enhanced capacity-building support.
  - **Grameen Credit Score:** Under Union Budget 2025, Public Sector Banks will establish a 'Grameen Credit Score' framework to meet the credit needs of self-help group (SHG) members and residents of rural areas.

- **Regulatory support:**
  - The Government has announced the establishment of a new mechanism under the Financial Stability and Development Council (FSDC) aimed at enhancing the financial sector's regulatory framework. This mechanism will evaluate the impact of current financial regulations and enhance their responsiveness to the needs of the financial sector.

How It Impacts The Industry?

- The increase in FDI limit for insurance sector is projected to attract substantial foreign capital, which will foster increased competition and invigorate the insurance sector and enhance its infrastructure.
- The support measures for MSMEs will strengthen the sector by improving their financial accessibility and supporting their growth potential in the economy.
- The initiatives aimed at financial inclusion and enhanced credit access to underserved areas will empower rural communities by providing essential financial support, stimulating economic growth, and improving livelihoods for millions of farmers, street vendors, and self-help group members.
- The establishment of a new Fund of Funds is expected to significantly enhance the startup ecosystem by providing crucial financial support, facilitating access to capital for early-stage ventures, and attracting further investments.
- The regulatory support steps taken are part of a broader strategy to create a modern, flexible, and people-friendly regulatory environment that supports economic growth and enhances the ease of doing business in India.

Our Point Of View

The Union Budget 2025 directly addresses some of the key industry demands and concerns and the measures undertaken are poised to drive significant growth and improvements across key areas. The insurance sector would witness more foreign investment, while MSMEs and underserved communities would benefit from enhanced financial support, improving economic opportunities and inclusivity. These steps would provide a robust foundation for long-term growth, stability and inclusiveness in the sector. Further, these reforms position the financial services industry for rapid expansion and innovation, with a strong influx of investments expected to flow in as a result.

Part 2: Tax implications

What The Industry Asked For?

- **Clarification on tax regulations for Virtual Digital Assets (VDA):**

  Cryptocurrencies and NFTs, defined as VDAs, in India remain unregulated, face a 30% tax on capital gains and an additional 1% TDS. The crypto industry is hoping that the Union Budget 2025 to introduce clearer regulations and revisit these tax rates to support sustainable growth in the sector.
- **Introduction of tax incentives to Debt Linked Savings Scheme (DLSS) in lines of Equity Linked Savings Scheme (ELSS):**

  Investments in DLSS should be eligible for deductions under Section 80C of the IT Act, in the same way that ELSS investments currently are, to create a level playing field for debt-oriented mutual funds.
- **Resolution of ambiguity in taxability of Carried Interest:**

  There is no express provisions under the direct tax laws determining the characterisation of carried interest in the hands of the investment manager. There are a couple of tax rulings under indirect tax parlance where carried interest paid to a fund manager is held as a service fee and therefore liable to GST. It is anticipated that a clarification concerning the characterisation of such carried interest will resolve the uncertainties and ambiguities about its potential tax implications, both under direct and indirect tax laws.
- **Tax regime for branch of foreign reinsurer operating in India:**

  Reinsurance companies are anticipating that the Union Budget 2025 will provide clarity on taxation of foreign reinsurer carrying on business in India through its branch office.
- **Clarification on implementation of IFRS Accounting Standard for Insurance Contracts:**

  Although the new accounting standard represents the transparency of Insurer's financial statements and performance, it inevitably presents challenges to be factored such as application of current value approach to measure insurance contracts might impact the estimation of future cash flows, unearned profit which is spread over term of contract or risk management associated with each underlying insurance contract etc. A suitable clarification with respect to its application for insurance contracts and its corresponding impact from taxation perspective is required for its successful implementation in the near future.

What Budget Gave?

Direct tax

INSURANCE

- **Rationalisation of tax implication on redemption of Unit Linked Insurance Policy (ULIP):** ULIP products not fulfilling prescribed conditions under section 10(10D) of the IT Act proposed to be classified as 'Non-Exempt ULIP' and thereby taxed under the head 'Capital Gains'. Therefore, any gains arising from redemption of such Non-Exempt ULIP shall be taxed under the head 'Capital Gains' and will form part of 'Equity Oriented Fund' as defined under the provisions of the IT Act.
- **Enhanced limit for tax withholding:** Tax withholding (TDS) threshold proposed to be increased from INR 15,000 to INR 20,000 in respect of remuneration/ reward for soliciting or procuring the insurance business
- **Contribution made to NPS Vatsalya eligible for deduction:** Deduction under section 80CCD of the IT Act (available under old tax regime) proposed to be extended to parent/ guardian contributing to NPS Vatsalya Scheme in respect of minor child (up to 2 children), subject to limit of INR 50,000.

INTERNATIONAL FINANCIAL SERVICE CENTRE (IFSC)

- Sunset dates for commencement of operations of IFSC unit for several tax concessions proposed to be extended to 31 March 2030.
- **Tax exemption:** The following tax exemptions are proposed to be introduced:
  - Proceeds received on life insurance policy issued by IFSC insurance intermediary office to non-residents.
  - Capital gains tax and dividend income arising from IFSC unit engaged in ship leasing.
  - Gains arising in hands of non-residents from transfer of specified instruments entered with Foreign Portfolio Investors (FPIs) being an IFSC unit.
- Excluding deemed dividend taxability in case where one of the group entities is a 'Finance company' or a 'Finance unit' as defined under IFSC regulations and the parent entity is listed on stock exchange outside India.
- All conditions relaxed for fund managers based in IFSC except for condition relating to aggregate participation up to 5% by resident investors where operations are commenced before 31 March 2030. Condition to be fulfilled within 4 months from specified date.
- Including retail scheme and Exchange Traded Funds within the definition of resultant fund for tax neutral relocation of original funds to such funds in the IFSC.

INVESTMENTS FUNDS

- Gains arising from transfer of securities held by investment funds referred to in the section 115UB of the IT Act proposed to be taxed as capital gains.
- Certain conditions for fund manager located in IFSC proposed to be relaxed.
- Benefit of capital gains taxable under section 112A of the IT Act proposed to be extended to Business Trusts.
- It is proposed to remove the provisions of Tax Collected at Source (TCS) under section 206C(1H) of the IT Act on sale of specified goods with effect from 1 April 2025, thereby keeping the sale of securities out of the ambit of TCS.
- Extension of sunset clause for making investment into infrastructure sector from 31 March 2025 to 31 March 2030 by Sovereign Wealth Fund and Pension Fund. Further, Long term capital gains on sale of unlisted debt investment proposed to be exempt (even if deemed as short-term otherwise)
- Long term capital gains on sale of unlisted debt investment proposed to be exempt.
- TDS rate on income paid by securitisation trust to a resident investor proposed to be reduced to 10%. Further, threshold for TDS in respect of payments such as interest on securities, dividend paid to individual shareholder and units of Mutual Fund specified under section 10(23D) of the IT Act, proposed to be increased to INR 10,000.
- Tax exemption available under section 10(4E) of the IT Act, proposed to be extended to income from non-deliverable forward contracts (NDFs), offshore derivative instruments (ODIs), and OTC derivatives entered with FPIs through IFSC units.

OTHER AMENDMENTS

- Tax exemptions proposed for amounts withdrawn by individuals on or after 29 August 2024 with respect to NSS deposits for which a deduction has been allowed earlier under section 80CCA of the IT Act.
- Requirement of higher TDS/ TCS in case of non-filer of tax return proposed to be removed in case of non-PAN cases.
- The period of exemption available in respect of income earned by Specified Undertaking of Unit Trust of India under section 13 of the UTI Repeal Act, 2002 proposed to be extended to 31 March 2027 (extended from 31 March 2025).
- **Extension of Tax Holiday for Startups:** It is proposed to extend the sunset date for claiming deduction by startups from 31 March 2025 to 31 March 2030.
- **Rationalisation of carry forward of losses in case of malgamation:** It is proposed to put a capping on the indefinite carry forward of losses and permits to carry forward the loss for 8 years from the year in which such loss has first been computed by the original predecessor entity instead of the year in which amalgamation has been effected.
- **Multi-year Arm's length determination for Intra-group transactions:** The Budget has proposed to introduce a progressive approach in transfer pricing assessments, by determining the Arm's Length Price (ALP) covering three consecutive years. This proposal seeks to shift to a more streamlined multi-year approach, where companies have transactions with their group companies by opting towards determination of ALP for three consecutive years as against for each year. Additionally, the scope of safe harbour rules is proposed to be expanded.
- **Furnishing information of crypto asset:** It is proposed to introduce reporting requirement for crypto transaction and penalties proposed for non-compliance or furnishing of inaccurate information.

Indirect tax

- Retrospective amendment in provisions dealing with blocked input tax credit (ITC) under GST law proposed to replace the phrase 'plant or machinery' with 'plant and machinery', which would result in restricting ITC of GST charged on construction of immovable structures qualifying as plant, to overcome the Supreme Court's ruling in Safari Retreats which allowed such ITC.
- Provisions related to time of supply of vouchers proposed to be omitted.
- Taxpayer allowed to reduce output tax liability in case of issuance of credit notes to a registered recipient only if ITC reversed by the recipient.
- Enabling provisions for invoice management system, to claim ITC and adjustment of outward liability, introduced.
- Input service distributor (ISD) mechanism to also govern distribution of ITC by ISD in respect of inter-state supplies on which tax has to be paid under reverse charge mechanism from 1 April 2025.
- **Insurance sector:** Retrospective amendment proposed to exempt reinsurance services provided under the Weather Based Crop Insurance Scheme (WBCIS) and the Modified National Agricultural Insurance Scheme (MNAIS) covering the period 01 April 2011 to 30 June 2017.

How It Impacts The Industry?

- The extension of the tax holidays for start-ups, IFSC units engaged in ship leasing, insurance and investment pooling activities along with the launch of new Fund of Funds in infrastructure to the tune of INR 10,000 crores (INR 100bn) will invite more capital infusion and strengthen India's position in financial services space.
- Rationalisation of safe harbour rules will make it easier for IFSC-based fund managers to manage funds located in other jurisdictions and will open the doors to consider relocation by the overseas Fund Managers.
- Increase in FDI limit in insurance from 74% to 100% will deepen the insurance market with innovation, global competitiveness, aligning with global best practices and building in innovative products.
- Announcement on revamping the current model Bilateral Investment Treaty (BIT) will make India as a jurisdiction to trade, more investor-friendly, at par with globally standards and attract foreign players.
- Extension of the current tax exemption enjoyed by the banking units to FPIs in IFSC on issuing ODIs would bring back the P-Note business in India and improve liquidity on IFSC exchanges.

  Clarity on characterisation of income earned by Category I and II AIFs as capital gains and parity with FPIs would settle the decade old pending demand from the fund's industry.
- Additionally, the rationalisation of TDS/TCS provisions will ease the compliance burden on businesses. The New Income Tax Bill to be placed next week will be simplified, taxpayer friendly, reduce ambiguity and reduce litigation.

INDIA UNION BUDGET 2025

Financial Services, and Insurance Sector Update

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119,611
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