Policy and tax reforms impacting the Financial Services sector

Keyur Shah

Partner - Financial Services Tax Leader

The FY24-25 Union Budget presented by the Indian Finance Minister is a strategic blueprint aimed at catalyzing the nation's journey towards 'Viksit Bharat' or Developed India. The focus on creating large-scale employment opportunities, accelerating the growth of the rural economy, and fostering a consumption-driven economy through these means is noteworthy.

The following are the key changes/ initiatives proposed to the Financial Services sector:

- Simplification of rules and regulations for FDI and OI in order to facilitate FDI, push for prioritization and promote opportunities for using Indian Rupee as a currency for OI
- Introduction of a 'variable capital company structure' under the regulations, for providing an efficient and flexible mode for financing leasing of aircrafts and ships in IFSC, and pooling funds for private equity players
- Strengthening and deepening or debt recovery tribunals
- Introduction of incentives for attracting investments in IFSC
- Emphasis on rationalization of tax implications in case of non-residents
- Major revamp in the taxation of capital gains

From a direct taxes standpoint, the Budget proposals aim to simplify taxes by rationalizing tax rates for capital gains, improve taxpayer services, maintain continuity and stability of taxation, and reduce litigation while enhancing revenues for funding the development and welfare schemes of the Government. A comprehensive review of the tax law is proposed to be completed in the next six months, with the objective of making it concise, lucid, easy to comprehend thereby reducing tax controversy and disputes as well as providing tax certainty to taxpayers.
From an indirect tax standpoint, the proposals aim to boost domestic manufacturing, reduce litigation and encourage trade facilitation. The endeavour will be to rationalize tax rates.

How does the budget impact the Financial Services sector?

Key policy proposals

- Proposed to introduce a financial sector vision and strategy document to set out the agenda for the sector for the next five years and guide the workings of government, regulators, financial institutions and market participants
- Introduction of a 'variable capital company structure' under the regulations, for providing an efficient and flexible mode for financing leasing of aircrafts and ships in IFSC, and pooling funds for private equity players
- Announcing comprehensive review of the income tax laws, proposed to be completed in the next six months, with the objective of making it concise, lucid, easy to comprehend thereby reducing tax controversy and disputes as well as providing tax certainty to taxpayers
- Comprehensive review of the rate structure under customs over the next six months to rationalize and simplify it for ease of trade, removal of duty inversion and reduction of disputes
- Proposal to provide for INR1.5 lakh crore to states as long-term interest free loans to support resource allocation
- Proposal to set up more than 100 branches of India Post Payment Bank in the North-east region to expand the banking services
- Provision of INR2.66 lakh crore for rural development including rural infrastructure is proposed

Key Direct Tax amendments

- Tax exemption extended to Retail schemes and ETFs set up in IFSC
  - Section 10(4D) of the IT Act provides tax exemptions on certain incomes earned by a 'Specified Fund' in IFSC. Currently, only non-retail schemes set up in IFSC as Category III AIFs and having only non-resident investors (except manager/sponsor contribution) are regarded as 'Specified Funds'
  - It is now proposed that retail schemes and ETFs regulated by IFSCA and which satisfy certain conditions as may be prescribed, will also be regarded as Specified Funds for claiming exemption under section 10(4D) of the IT Act
  - The tax rate applicable to a Specified Fund in IFSC are as under:

Securities	Nature	Tax Rate **
Indian	Capital gains on Equity	Taxable (12.5%/ 20%)
	Capital gains – Debt / Derivative, etc	Exempt
	Interest / Dividend	10%
IFSC / Global Securities	Interest (IFSC securities)	10%
	Capital gains on Global/ IFSC Securities or any income from Global securities	Exempt

** Above tax incentives are to the extent of non-resident unitholders

Highlights

100 branches

to be set up by India Post Payment Bank

Introduction of variable capital company structure

INR1.5 lakh crore

To provide as long-term interest free loans

STCG	15%	→	20%
LTCG	10%/ 20%	→	12.5%

Applicable for assets transferred on or after 23 July 2024

Thin capitalization exemption to finance companies set-up IFSC

- Currently, interest payment made to non-resident associated enterprises is restricted to 30% of EBIDTA, with NBFCs, banks and insurance companies being exempted from this restriction
- It is proposed that a Finance Company set up in IFSC, under the IFSC Authority (Finance Company) Regulations, 2021 which satisfies conditions and carries on activities, as may be prescribed, will be exempted from these provisions

Exemption to VCF set up in IFSC

- Currently, where source of credits/ funds is not explained, the same is subject to income-tax. Further, it is prescribed that source of such creditor/ lender/ shareholder is also required to be explained. This requirement (verifying source of source) was exempted for SEBI registered VCFs
- Budget 2024 extended the relaxation in place to VCFs regulated by IFSCA

Exemption from levy of surcharge

- Finance Act, 2023 provided exemption from levy of surcharge on dividend and interest income earned by Specified Funds in IFSC. However, such exemption was restricted to Specified Funds set-up as AOP not having all members as corporates
- It is now proposed to extend the exemption to all Specified Funds

Tax exemption on core settlement guarantee funds set-up by clearing corporation in IFSC

- Specified income of core settlement guarantee funds, set up by a recognized clearing corporation in accordance with Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 is exempt
- It is proposed to extend the exemption to specified income earned by core settlement guarantee funds set-up by a clearing corporations registered under the IFSCA (Market Infrastructure Institutions) Regulations, 2021

Corporate tax rate for foreign companies reduced

- Corporate tax rate for foreign companies reduced from 40% to 35%
- Effective headline tax rate of 38.22% (including surcharge and health and education cess)

Amendment to the provisions of specified mutual fund

- Currently, units of a SMF are considered as short-term capital assets irrespective of their period of holding
- SMF is defined as a mutual fund where not more than 35% of its total proceeds are invested in the equity shares of domestic companies
- With an intent to provide clarity regarding the proportion of investment in debt and money market instruments as well as to clarify the applicability of these provisions in case of FoFs, the definition of SMF has been replaced to mean:
    - a mutual fund, by whatever name called, investing more than 65% of its total proceeds in debt and money market instruments (defined as any security classified or regulated as such, by the SEBI); or
    - a fund investing 65% or more of its total proceeds in units of a fund referred above
- Separately, unlisted debentures and bonds are also now deemed to be short-term capital assets irrespective of their period of holding
- The above amendment will take effect from 1 April 2025 and will be applicable to transfers on or after 23 July 2024

Amendments in the provisions of capital gains

- Capital gains tax rate applicable in respect of various assets is as tabulated below:

Description	Existing rate* (%)	Proposed rate * (%) w.e.f. 23 July 2024
STCG under section 111A (STT paid equity shares, units of equity oriented mutual fund and unit of a business trust)	15	20
Other STCG of specified funds or Foreign institutional investors under section 115AD	30	30
Other STCG	Applicable slab rates	Applicable slab rates
LTCG under 112A (STT paid equity shares, units of equity oriented mutual fund and unit of a business trust)	10 above LTCG of INR1 lakh	12.5 above LTCG of INR1.25 lakhs
Listed bonds and debentures**	20	12.5
Other LTCG**	10/ 20	12.5

*as increased by applicable surcharge and cess

** Other LTCG of specified funds or Foreign institutional investors under section 115AD continues to be taxed 10% (plus applicable surcharge and cess)

With respect to unlisted debentures and bonds, there could be a debate on the characterization of income and rate of tax applicable for FPIs. The same shall need to be evaluated and deliberated

- The holding period for all listed securities including units of business trust and equity oriented mutual funds will now be a common period of 12 months to be classified as long-term capital assets. All other assets will qualify as long-term capital assets if held for 24 months or more
- Gains from unlisted bonds and debentures transferred, redeemed or maturing on or after 23 July 2024 will be treated as short-term capital gains irrespective of the holding period
- No indexation benefit in case of any long-term capital assets

Taxation of buy-back proceeds as dividend for shareholders

- Currently, buy-back tax is payable by domestic companies at the rate of 23.30% (including surcharge and health and education cess) on buy-back of shares and the same is exempt in the hands of shareholders
- It is now proposed that buy-back tax will be abolished and such income will be taxable in the hands of the shareholders as "deemed dividend"
- No deduction for expenses will be available against such dividend income
- Domestic company to withhold tax at 10% from payment to resident shareholders
- Cost of acquisition of shares to be treated as capital loss in the hands of shareholders and allowed to be set-off and carry forward against capital gains
- This provision is effective 1 October 2024

Removal of angel tax provisions

- Currently, angel tax provision is applicable to companies on receipt of consideration in excess of fair market value for issue of shares to investors
- Now, angel tax has been proposed to be removed with effect from 1 April 2025

Amendment in STT rates

- Considering the exponential growth of the derivative segment in recent times, the new STT rates with effect from 1 October 2024 will be as under:

Nature of Transactions	Current rate	Proposed rate	Remark
Delivery based purchase transaction in equity shares on a recognized stock exchange	0.1%	0.1%	No change
Delivery based sale transaction in equity shares on a recognized stock exchange	0.1%	0.1%	No Change
Transaction for sale of an option in securities	0.0625%	0.1%	Increase
Transaction for sale of an option in securities, where option is exercised	0.125%	0.125%	No change
Transaction for sale of futures in securities	0.0125%	0.02%	Increase

Abolition of Equalisation Levy on e-commerce supply or services

- Currently, 2% Equalisation Levy is applicable on consideration received or receivable by a non-resident e-commerce operator from e-commerce supply or services
- In light of ambiguity and increased compliance burden, it is now proposed that 2% Equalisation Levy will no longer be applicable
- This provision is effective 1 August 2024

Amendment in the manner of computation of income of life insurance business

- Currently, taxation of life insurance business is governed by section 44 of the IT Act which overrides the normal computational provisions from sections 28 to 43B of the IT Act
- The taxation of a life insurance business is governed by a specific code under the First Schedule of the IT Act which takes into consideration the actuarial surplus computed in accordance with the Insurance Act, 1938
- It is now proposed that any expense inadmissible under section 37 of the IT Act shall be added to the profits and gains of a life insurance businesses
- This amendment will be effective from 1 April 2025

Cost of acquisition for equity shares under offer for sale in an IPO

- On withdrawal of long-term capital gain exemption on listed shares in 2018, specific provisions were introduced to provide for the computation of cost of acquisition, considering fair market value as on 31 January 2018
- The provisions created ambiguity for computation of such fair market value of equity shares transferred pursuant to an offer for sale under an IPO
- Now, fair market value of such equity shares will be the cost of acquisition adjusted with the Cost Inflation Index upto FY 2017-18
- The amendment will take effect retrospectively from AY 2018-19

TDS on specified government securities

- Currently, no tax is to be withheld on securities issued by the Central Government or State Government except on 8% Savings (Taxable) Bonds, 2003 or 7.75% Savings (Taxable) Bonds, 2018 (where payment exceeds INR10,000)
- It is now proposed to withhold taxes on Floating Rate Savings Bonds (FRSB) 2020 (Taxable) and any security of the Central Government or State Government, as the Central Government may notify (where payment exceeds INR10,000)
- This amendment will be effective from 1 October 2024

Capital gains tax exemption for corporate gifts removed

- Currently, transfer of a capital asset under a gift or will or an irrevocable trust is not considered as transfer for purpose of capital gains
- This exemption will now be applicable only to such transfers by individuals and HUFs
- It is proposed to tax the gifts received from corporates
- This amendment will be effective from 1 April 2025

Disallowance of expenditure incurred for settling proceedings in contravention of any law

- Typically, settlement amounts are incurred due to an infraction of law and relate to contraventions, etc. and, therefore, should not be allowed as business expenses
- It is now clarified that expenditure incurred by a taxpayer to settle proceedings initiated in relation to a contravention under any law, as notified by the Central Government, shall be treated as expense incurred for any purpose which is prohibited by law and hence shall be disallowable
- The amendment is proposed to be made effective from 1 April 2025 onwards

Penal provisions introduced to comply with the AEOI framework

- There existed a penalty of INR5,000 for every inaccurate reportable account at the time of furnishing the SFT return
- It is proposed to extend the penalty of INR 50,000 under the following circumstances:
  - furnishing inaccurate information in the statement shall be liable
  - failure to comply with due diligence requirement in the statement
- This provision is effective 1 October 2024

Other updates

- Withholding tax rates have been proposed to be amended which include, inter alia
  - In case of pay-outs under life insurance policy to a resident policyholder and payment of insurance commission, the rate is proposed to be reduced to 2% from existing 5%
  - Withholding tax rate on repurchase of units by Mutual Fund or Unit Trust of India is proposed to be abolished
  - Withholding tax rate in case of e-commerce operator has been reduced to 0.1% from existing 1%

Key indirect tax amendments

Future litigation framework

- Introduction of Section 74A in the CGST Act – with single limitation period of 3.5 years (from date of annual return filed) for all cases
- Definitive time limit set for passing orders - 12 months from the date of notice (discretion to extend by six months)
- No ITC restriction for taxes paid under this recovery provision under section 17(5)
- Maximum pre-deposit amounts payable at first appeal and Appellate Tribunal level - reduced to 10% of the tax demand (subject to maximum of INR20 Crores each)
- Section enabling authorised person to appear for summons before authorities and give statement

Resolving past controversy

- Dispute resolution provisions introduced to clear past litigations (excluding erroneous refunds) - conditional waiver of interest and penalty for demands under Section 73 for periods upto FY 2019-20
- GST Council empowered under Section 11A to regularize non-levy or short levy of GST, provided tax was short paid/ not paid due to generally prevalent trade practice - Several impending industry issues likely to be considered for evaluation
- ITC for period 1 July 2017 to 31 March 2021, can be claimed in returns filed upto 30 November 2021
- Section 13(3) of CGST Act amended to clarify that the time of supply of services from unregistered vendors where invoices are to be issued under RCM should be date of payment/ date of self invoice
- Schedule III of the CGST Act, 2017 amended – Supplies treated neither as a supply of goods or services to include
    - Co-insurance premium earned by the co-insurer from the lead insurer
    - Re-insurance commission

Other amendments

- BCD reduced to 6% on import of gold and silver bars
- GST Compensation Cess on imports by SEZ Units/ SEZ Developers for authorised operations to be exempted retrospectively
- BCD exemption on import of parts and components of cash dispenser or automatic bank note dispenser extended upto 31 March 2026
- Exemption on import of foreign currency coins into India by a Scheduled Bank to lapse effective 1 October 2024

Impact analysis

The Budget introduces several measures to rationalize the tax rates as well as simplify the computational mechanism of the current tax law, promote the financial markets, support development of the IFSC, and ensure overall fiscal management of the economy. Further one does look forward to the new and amended IT Act which is to be announced in six months.

All in all, one does feel that the budget is forward looking and should provide an impetus for the creation of 'Atma Nirbhar Bharat' (self-reliant India).

Glossary

AEOI - Automatic Exchange of Information

AIF – Alternative Investment Funds

AOP - Association of persons

BCD – Basic Customs Duty

CGST Act – Central Goods and Services Tax Act, 2017

EBIDTA - Earnings before interest, depreciation, taxes, and amortization

ETF – Exchange Traded Funds

FDI – Foreign Direct Investment

FOFs - Fund-of-Funds

GST – Goods and Services Tax

HUF – Hindu Undivided Family

IFSC - International Financial Services Centre

IFSCA - International Financial Services Centres Authority

IRDAI - Insurance Regulatory and Development Authority of India

IT Act - Income-tax Act, 1961

ITC – Input Tax Credit

LTCG - Long-term Capital Gains

NBFC –Non-Banking Financial Corporation

OI - Overseas Investments

PE – Permanent Establishment

SEBI - Securities and Exchange Board of India

SEZ – Special Economic Zone

STCG - Short-term Capital Gains

SFT – Statement of Financial Transactions

STT – Securities Transaction Tax

TDS – Taxes Deducted at Source

VCF – Venture Capital Fund

For details on other sectors and solutions visit our website Union Budget 2024

Download the EY India Tax Insights App for detailed insights on tax and regulatory reforms.

Our offices

Ahmedabad
22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon Temple
Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

Bengaluru
12th & 13th Floor
"UB City", Canberra Block
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground & 1st Floor
11, 'A' wing
Divyasree Chambers
Langford Town
Bengaluru - 560 025
Tel: + 91 80 6727 5000

Bhubaneswar
8th Floor, O-Hub, Tower A
Chandaka SEZ, Bhubaneswar
Odisha – 751024
Tel: + 91 674 274 4490

Chandigarh
Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai
6th & 7th Floor, A Block,
Tidel Park, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR
Ground Floor
67, Institutional Area
Sector 44, Gurugram - 122 003
Haryana
Tel: +91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad
THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jaipur
9th floor, Jewel of India
Horizon Tower, JLN Marg
Opp Jaipur Stock Exchange
Jaipur, Rajasthan - 302018

Kochi
9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata
22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

3rd Floor, Unit No 301
Building No. 1
Mindspace Airoli West (Gigaplex)
Located at Plot No. IT-5
MIDC Knowledge Corridor
Airoli (West)
Navi Mumbai - 400708
Tel: + 91 22 6192 0003

Pune
C-401, 4th Floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

10th Floor, Smartworks
M-Agile, Pan Card Club Road
Baner, Taluka Haveli
Pune - 411 045
Tel: + 91 20 4912 6800

Ernst & Young LLP

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EYG member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

Ernst & Young LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/en_in.

Ernst & Young LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at Ground Floor, Plot No. 67, Institutional Area, Sector - 44, Gurugram - 122 003, Haryana, India.

ey.com/en_in

@EY_India EY EY India EY Careers India @ey_indiacareers