

Push for financial services, but...

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Though the Budget has proposed some sops for the financial services sector on the policy front, from a tax perspective, a lot more could have been done.



The overall transaction-related costs associated with trading on the capital market could have been reduced.

The Finance Minister had the challenge of having to prepare a Budget that would “please all” and yet maintain a sustainable growth trajectory for the economy. The general expectation was that the Budget would provide some stimulus to the financial services sector and, at the same time, address the key challenges faced by the industry on the tax front.

Though the Budget has proposed some sops for the industry on the policy front, it has been disappointing from a tax perspective, as a lot more could have been done.

Flexibility to IIFCL

Some of the positive policy initiatives taken in the Budget include the commitment shown by the Government to provide greater flexibility to India Infrastructure Finance Company Ltd (IIFCL), to aggressively fulfil its mandate of providing long-term financial assistance to infrastructure projects.

The direction provided by the Government to IIFCL to work with banks to evolve a ‘takeout financing’ scheme, which could facilitate incremental lending to the infrastructure sector and effectively address the asset-liability mismatch of banks arising from financing infrastructure projects, is another positive measure.

The Government has also mandated IIFCL to refinance 60 per cent of the bank loans for Public-Private Partnership projects in crucial sectors over the next 15-18 months; this is a step in the right direction as it will help free up bank capital to finance new projects.

Financial inclusion

As part of the financial inclusion drive, the Government has allocated Rs 100 crore as a one-time grant-in-aid to ensure provision of at least one banking centre in each un-banked area in the country; this should help take basic banking facilities to every corner of the country.

The Government has also indicated its commitment to retain public sector enterprises such as banks and insurance companies within the public sector and has committed to provide them with the necessary support, including capital infusion, to grow and remain competitive.

Recognising that the New Pension System (NPS) will play a pivotal role in the development of a sustainable, efficient and voluntary pension system, the Government has rightfully exempted the income earned by the NPS Trust from income-tax, Securities Transaction Tax (STT) and Dividend Distribution Tax (DDT), thus ensuring that the tax treatment of savings under the NPS is synchronised with the 'Exempt-Exempt-Tax' method of tax treatment of savings and making the NPS Trust a complete tax pass-through vehicle.

Transaction costs

The Budget, however, has failed to address various fiscal measures that could have been taken to provide additional support to the financial sector. For example, it did not reduce the overall transaction-related costs associated with trading on the Indian capital markets, given that they are rated globally among the most expensive to trade on.

This could have been achieved by reducing the overall STT rates, or reinstating the rebate mechanism for claiming credit for STT paid as opposed to the current mechanism of having traders claim a tax deduction for STT paid.

It would have been helpful if some guidance had been provided on the tax front for various capital market-related transactions/instruments such as stock lending and borrowing, IDRs, financially engineered products, etc. The Budget should have also provided clarity on the taxation of trusts set up by asset reconstruction companies (ARCs) and investors in such trusts.

The Government could have also provided certain sops to banks/financial institutions — for example, by reinstating tax exemptions for long-term financial support provided to infrastructure projects, or by affording priority sector lending status for bank finance to this sector. The Government should have aligned the accounting and tax treatment in relation to loan provisioning by banks/NBFCs, given the present financial situation.

Clarity was also needed on the tax treatment to be adopted by banks/NBFCs proposing to use innovative financial instruments, such as perpetual debt instruments, to raise capital to meet their capital adequacy ratio (CAR) requirements and to ensure that such instruments are indeed used successfully by banks/NBFCs to meet their funding requirements.

Banks, mutual funds

Banks were hopeful that the Budget would seek to address the disparity that exists in the case of their investment product offerings to retail investors for claiming tax deductions under Section 80C.

Banks believe they are currently disadvantaged vis-À-vis mutual funds when it comes to soliciting deposits from retail investors for granting Section 80C tax benefits, as the investors have to lock their funds with banks for a minimum tenure of five years, while the minimum lock-in period for investing in similar products offered by mutual funds is three years. Unfortunately, these proposals received no mention in the Budget.

Though, on the face of it, it may appear that it could have done more, all in all it is a fairly good Budget as it has targeted an annual growth rate of 9 per cent, and has put much more emphasis on the infrastructure sector, which is so intertwined with the financial services sector.

Hopefully, the Finance Minister will seek to address the key tax issues relating to financial services, when he releases the new income-tax code within the next 45 days.