Grant Thornton

Union Budget 2010-11

BFSI (Banking, Financial Services and Insurance)

- A strong BFSI sector is a vital cog in the wheel of a developing country like India which is embarking on the road to achieve double digit growth
- The banking sector index has grown at a compounded annual rate of over 51% in last decade. This sector has the potential to account for over 7.7% of Gross Domestic Product (GDP) with over Rs.7,500 billion in market capitalisation and to provide over 1.5 million jobs
- India is the 5th largest life insurance market in the emerging insurance economies globally. The sector is growing at a healthy rate of about 32% annually
- The collapse of global financial behemoths in the western financial markets coupled with banking crises in the various economies of the world raised serious concerns on the stability of the banking sector. The tightening of capital adequacy norms along with a robust mechanism for monitoring risk has become paramount
- Both the Banking and the Insurance sector have generated keen interest amongst Foreign Institutional Investors, however, the current Foreign Direct Investment (FDI) restrictions have held them back. Perhaps the government plans to install stronger monitoring mechanisms before opening up the sector to foreign capital
- Overall these sectors are at the threshold of explosive growth and liberal policy measures will only help enhance the competitiveness by introducing new players and also benefit the consumers in the long run

Key Expectations

- Recapitalisation of Public Sector Undertakings (PSUs) banks with lower Tier 1 Capital
- Re-financing from India Infrastructure Finance Company Limited (IIFCL) up to 60% of commercial bank loan for Public Private Partnership (PPP) projects in critical sectors expected to continue
- Increase the FDI limit in insurance sector from 26% to 49%
- Increase the FDI limit in public sector banks from 20% to 49%
- Interest subvention for pre-shipment credit and short term crop loan is likely to be rolled back
- Relaxation in lock-in periods for fixed deposits from five to three year, in order to qualify for tax benefits under Section 80C
- Increase in tax breaks to housing finance and infrastructure-lending companies from the existing limit
- Allow banks and infrastructure lending companies to raise tax-free infrastructure bonds
- Carry forward of losses should be allowed for 10 years to the insurance industry considering the long gestation period
- Allow full deduction for provision made towards bad and doubtful debts from the current rate of 7.5% of total income
- Agricultural debt waiver and debt relief scheme to be extended

Key Expectations

Recapitalization of PSU banks

Continuation of re-financing from IIFCL up to 60%

Increase in FDI Limits in Insurance and Banking Sector

Relaxation of lock-in periods for fixed deposits-benefit under Section 80C

Tax breaks for housing and infrastructure lending companies

Key Policy Initiatives

General Policy Changes

- An apex level Financial Stability and Development Council is proposed to strengthen the mechanism for maintaining financial stability
- Reserve Bank of India is mulling over the proposal to grant new banking licenses to private sector players including Non Banking Financial Company (NBFC)
- Public sector banks to get Rs 16,500 crores towards maintaining Tier-1 capital
- Recapitalisation of Regional Rural Banks (RRBs) to support incremental lending to rural economy
- Refinancing of bank lending to infrastructure projects by IIFCL is intended to be doubled
- Provision for banking facilities to villages with population in excess of 2000 by March 2012
- Financial Inclusion Fund and Financial Inclusion Technology Fund to be augmented by Rs 100 crores each
- Micro-finance development and equity fund doubled to Rs 400 crores
- Credit availability targets for farmers increased from Rs 325,000 crores to Rs 375,000 crores
- Rasthriya Swasthya Bima Yojana extended to Mahatma Gandhi National Rural Employment Guarantee Act (NREGA) beneficiaries
- Agricultural debt waiver and debt relief scheme to be extended till 30 June 2010
- Provision of Insurance and other services using Business Correspondent model for covering 60,000 habitants
- 1% interest subvention on housing loans up to Rs. 10 lakh and where the cost of house does not exceed Rs. 20 lakh, extended up to 31 March 2011

Direct Tax Changes

- Corporate tax rate unchanged
- Existing surcharge for domestic companies proposed to be reduced from 10% to 7.5%
- Minimum Alternate Tax (MAT) proposed to be increased to 18% from 15%
- Increase in threshold limit for deduction of tax from payment of insurance commission to Rs. 20,000

Non Life Insurance Company

- The unrealized gain due to appreciation/provision for losses in the value of investments not to be considered while arriving at the taxable income
- Further, gain or loss on realisation of investments shall be added/ reduced for arriving at the taxable income provided the same is not already reflected in the taxable income

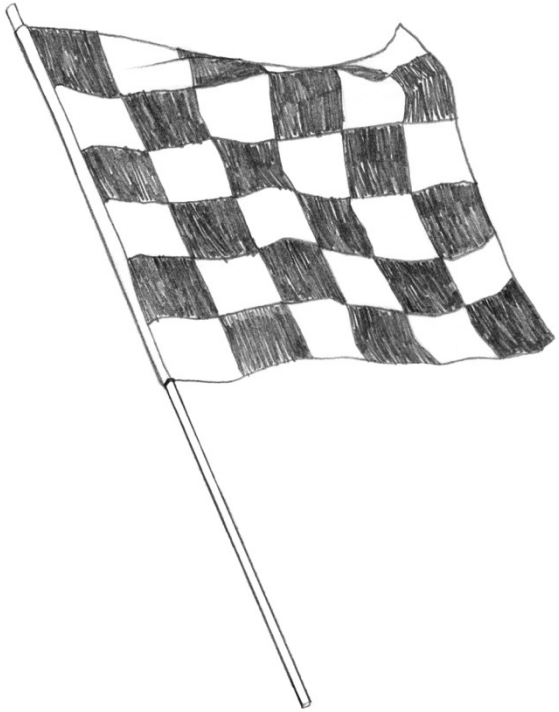
Indirect Tax Proposals

Service tax

- Under management of investments under Unit Linked Insurance Plan (ULIP) services, the value of taxable service for any year of operation of policy shall be the actual amount charged by the insurer for management of funds under ULIP or the maximum amount of fund management charges fixed by Insurance Regulatory and Development Authority (IRDA) whichever is higher

- Health services provided under health insurance schemes offered by insurance companies. The tax on these health services would be payable only if the payment for such health check up or preventive care or treatment etc. is made directly by the business entity or the insurance company to the hospital or medical establishment

- Service tax on commercial rent has been reintroduced. This will impact most of the financial sector companies as rent is a significant component of their cost



Expert Viewpoint

Apex Regulatory Council

- With the global meltdown in the financial sector and the collapse of large financial behemoths, the finance minister has decided to take a pro-active step to monitor the country's macro prudential environment. This has led to the creation of the apex body – Financial Stability and Development Council
- This body will not only help monitor large financial conglomerates but also provide co-ordination between the financial regulators. This could help in a quick resolution of disputes such as the recent skirmish between the Securities and Exchange Board of India (SEBI) and the IRDA over the ULIP issue

Financial Support to the Public Banking Sector

- If the economy is to meet its robust GDP targets, it is imperative to have a strong banking system that can support the rise in the credit off take
- Public Sector banks were in dire need of low risk capital to meet their capital adequacy norms and be competitive with the private sector. With FDI being ruled out and the cost of retail deposits spiral, only equity infusion from the government could save PSU banks
- The policy decision to infuse Tier 1 capital into PSU banks has come as a welcome relief and will provide the much needed stimulus to the banks

Credit Support to Farmers

- One of the four-pronged approach to provide an impetus to the agricultural sector was to augment the target for credit support to the farmers. The target for 2010-2011 has been set at 3.75 lakh crores, which represents an increase 50,000 crores over the last year

Banking Sector –Widening the Reach

- Improving the penetration of the banking sector has been a very important consideration and hence budgetary allocations have been made to Financial Inclusion Fund and Financial Inclusion Technology Fund to help take banking services to the hitherto unbanked areas of the country
- The Finance minister also proposed to issue additional banking licenses to private sector players and NBFCs in a bid to enhance the competitiveness in the sector and also enhance the geographical coverage
- More NBFCs will lead to increase in liquidity

Unfulfilled Expectations

- One of the major expectations, particularly of the insurance industry was the enhancement of the FDI limit. Although this has been a long standing demand of this industry, there was no announcement in this regard.
- Banks were hoping that the 7.5% limit on the tax deductibility of bad & doubtful debts would be enhanced, but this expectation was not met. This would have been a positive change since the Non Performing Asset (NPA) levels of several banks are higher than the income tax specified limits

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