VINOD KOTHARI CONSULTANTS

# Union Budget 2025

Key Highlights and Reforms
focusing on Financial Sector Entities

# Key Highlights

- The new Income Tax Bill to be tabled next week - hence, for tax reforms, one will see a bunch of proposals in the new Bill
    - Of course, the Bill will have some discussion pan-India before being passed. We hope it is not rushed through, as it is a very significant measure of policy, and impacts economic activity in many ways

- FDI in insurance goes up to 100%
    - There are conditionalities of course. We will need to await the details

- Partial Credit Facility by NaBFID for corporate bonds for infrastructure
    - NaBFID is regarded as an AIFI and is subject to capital rules as applicable to banks. The issue with the PCE facility is the capital requirement which is based on the capital relief obtained by the issuer due to the PCE. Ironically, this capital requirement remains fixed for the entire term of the bonds, even though the bonds amortise over time. We hope this issue is resolved.

# Key Highlights

- Carry forward of losses in mergers not to be allowed
  - Mergers not to be used for evergreening of losses: benefit of carry forward and set off to be limited 8 years of onset, and not 8 years of merger
  - In case of demerger, the existing provision of sec. 72A (4) will continue to apply - note that there is no evergreening here, as the vintage of the loss does not shift to the year of demerger under this provision

- Specific benefits to ship-leasing units, insurance offices and treasury centres of global companies which are set up in IFSC along with funds under relocation regime
  - Tax concessions proposed to be extended
  - Exemption to capital gains and dividend for ship leasing units in IFSC
  - Rationalisation of definition of ‘dividend’ for treasury centres in IFSC
  - Simplified regime for fund managers based in IFSC
  - Amendment of Section 10 related to Exempt income of Non-Residents
  - Inclusion of retail schemes and Exchange Traded Funds (ETFs) in the existing relocation regime of funds of IFSCA

# MSME Classification Criteria Revised

- The investment and turnover limits for classification of all MSMEs will be enhanced to 2.5 and 2 times respectively for improving access to capital and technology upgradation.
- This will increase the ambit of entities who will be eligible to classify and register themselves as MSMEs. At the same time the existing MSMEs will not require reclassification even after expansion within the revised limits.
- Loans/ funding extended to MSMEs registered with Udyam will also be eligible to be classified as PSL.
- The applicability is yet to be notified under the MSME Act.

| *₹ in crores* | **Investment** | | **Turnover** | |
|---|---|---|---|---|
| | **Existing** | **Revised** | **Existing** | **Revised** |
| **Micro Enterprise** | 1 | 2.5 | 5 | 10 |
| **Small Enterprise** | 10 | 25 | 50 | 100 |
| **Medium Enterprise** | 50 | 125 | 250 | 500 |

# Financing to MSMEs

- **Enhancement of credit availability with guarantee cover:**

| | Credit Guarantee Cover (in crores) | |
|---|---|---|
| | **Current** | **Revised** |
| **MSEs (CGTMSE)** | 5 | 10 |
| **Startups (CGSS)** | 10 | 20 |
| **Exporter MSMEs** | For Term Loans upto 20 crore | |

- **Reduction in Guarantee Fees for Startups:** In addition to enhanced guarantee cover, the guarantee fee has been lowered from 2% to 1% for loans in 27 key sectors critical to Atma Nirbhar Bharat.

- **Credit Cards for Micro Enterprises:** Customised Credit Cards with a ₹5 lakh limit has been introduced for Udyam registered Micro Enterprises (10 lakh cards will be issued in the first year). The details are yet to be notified.

# FDI in Insurance

- The sectoral cap for Insurance Sector to be raised from existing 74% to 100% for those companies which invest the entire premium in India
    - The sectoral cap of 74% was brought in *vide* the budget of FY 21-22 from 49% with certain conditions i.e. majority of directors on the board and KMPs would be resident Indians, with at least 50% of directors being independent, and specified percentage of profits to be retained as general reserve.
- The current guardrails and conditionalities associated with foreign investment will be reviewed and simplified.
- Section 27E of the Insurance Act, 1938, restricts insurance companies from investing the funds of the policy holders outside India.
- Section 27C of the said act allows an insurer to invest not more than 5% in aggregate of its controlled fund or assets as referred to section 27(2) in the companies belonging to the promoters, subject to such conditions as may be specified.
- Hence, conditions specified in the FDI seems to be stricter than the Insurance Act.

# TDS on Securitisation Transactions

- Earlier, the TDS rates applicable on income from securitisation transactions were as follows:
  - 25%, if the payee is an individual or a Hindu undivided family;
  - 30%, if the payee is any other person.
- Now, the Finance Ministry has proposed reducing the TDS rate on income distributed by securitisation trusts under Section 194LBC **to 10%** which is at par with bonds. This will be applicable April 1, 2025.
- Vinod Kothari Consultants and the Indian Securitisation Foundation had strongly advocated for this change and recommendation was made to both DEA and to SEBI. We are pleased that the Ministry has acknowledged these recommendations. This move is expected to provide a significant boost to the Indian securitisation market.
- The recommendations can be viewed here : Representation for regulatory amendments to promote securitisation market in India

# CKYCR and Periodic Updation

- **Revamping the Central KYC registry to simplify the KYC process:**
    - Central KYC Registry (CKYCR) is a centralized repository of KYC records for customers in the financial sector. The CKYCR's purpose is to reduce the need for customers to provide KYC documents each time they open a new financial account.
    - Budget 2025 further proposes to simplify the KYC process by revamping the CKYCR.

- **Proposal to implement a streamlined system for periodic updation of KYC:**
    - KYC Directions for RBI regulated entities mandate a periodic updation of the customers to be carried out for ensuring that the information or data collected during the initial KYC is kept up-to-date and relevant. Periodic updation is based on the customer’s KYC risk categorisation.
    - It has now been proposed to implement a system which will streamline the periodic updation process.

# Merger of Companies

- Requirements and procedures for speedy approval of company mergers will be rationalized
- Simplification in the process of Fast Track Mergers (FTMs)
  - To be notified separately
- Expansion of the scope for FTM
  - Presently, FTM is permissible when entered into between any of the following class of companies:
    - Two or more small companies;
    - Between a holdco and its WOS;
    - Two or more start-up companies; or
    - One or more start-up co with one or more small co.

# Carry forward of losses in case of amalgamation

- Provisions of law:
  - Sec 72A and 72AA: Accumulated loss of the amalgamating entity or predecessor entity shall be **deemed to be the loss** of the amalgamated entity or the successor entity.
  - Sec 72: PGBP losses (other than from speculation business) cannot be carried forward for more than 8 AYs immediately succeeding the AY for which the loss was first computed.

- To align with Sec 72, it is proposed to amend Sec 72A and 72AA, limiting the carry-forward of such deemed losses to **8 AYs from when they were first computed for the original predecessor entity**. This aims to prevent the perpetual carry-forward of losses through successive amalgamations.

- Applicability: Any amalgamation or business re-organisation effected on or after 01st April, 2025.

- In case of demerger, the existing provision of sec. 72A (4) will continue to apply - note that there is no evergreening here, as the vintage of the loss does not shift to the year of demerger under this provision.

See also our article on the subject here.

# Credit Enhancement Facility by NaBFID

- **NaBFID will set up a 'Partial Credit Enhancement Facility' for corporate bonds for infrastructure**
  - Earlier infrastructure operators relied on bank funding. Due to this, the bond penetration was very low.
  - NaBFID's participation in providing guarantees will boost bond issuances and investments in infrastructure bonds, particularly from institutional investors.
  - Under RBI's Partial Credit Enhancement to Corporate Bonds dated September 24, 2015, guarantees of up to 20% are permitted, meaning every ₹20 of guarantee can facilitate ₹100 of investment. This makes NaBFID's PCE facility highly impactful.

# Incentives to IFSC - (1/5 )

**Tax Concessions**

- Sunset dates for commencement of operations of IFSC units for several tax concessions, or relocation of funds to IFSC proposed to be extended
- Extended till 31st March, 2030
- Effective date - April 01, 2025

**Income of Non-residents**

- Proposed to amend clause (4E) of section 10 to provide that the income of a non-resident on account of transfer of non-deliverable forward contracts or offshore derivative instruments or over the-counter derivatives, or distribution of income on offshore derivative instruments, entered into with FPIs being an IFSC unit shall also not be included in the total income subject to certain conditions as may be prescribed.
- Effective date - 1st April, 2026
- Applicability - AY 26-27 and subsequent assessment years

# Incentives to IFSC - Ship Leasing (2/5 )

It is proposed to extend the exemptions provided to the aircraft business[1] further to ship leasing business[2]. Following exemptions are proposed to be extended:

- Exemption in section 10(4H) to capital gains for non-resident or a unit of IFSC engaged in ship leasing on transfer of equity shares of a ship leasing domestic company.
- Exemption in section 10(34B) to dividend paid by a ship leasing company in IFSC to a unit of IFSC engaged in ship leasing.
- Effective date - 1st April, 2025

Our article on the topic can be read here:
[1] https://vinodkothari.com/2023/11/aircraft-leasing-in-ifsc/
[2] https://vinodkothari.com/2023/11/ship-leasing-from-ifsc-a-new-business-takes-shape/

# Incentives to IFSC- Treasury Centres (3/5)

Proposed to rationalise definition of ‘dividend’ for treasury centres.

- **Rationale**:  borrowings by the corporate treasury centre in IFSC from any group entities could trigger deemed dividend provisions in the hands of the shareholder
- **Proposed amendment**: Advance or loan shall not be treated as ‘dividend’, provided such advancement shall be between the group entities where:
    - One of the group entities shall be a  “Finance company” or a “Finance unit” in IFSC set up as a global or regional corporate treasury centre for undertaking treasury activities or treasury services
    - ‘Parent entity’ or ‘principal entity’ of such ‘group entity’ is listed on stock exchange in a country or territory outside India
- Conditions for a ‘group entity’, ‘principle entity’ and the ‘parent entity’ shall be prescribed
- **Effective date** - 1st April, 2025

# Incentives to IFSC- Fund Managers (4/ 5)

- Proposal to provide a simplified safe harbor regime for investment funds managed by fund manager based in IFSC
- **Rationale**: There is a need to provide a specific simplified regime for IFSC based fund managers, managing funds situated in other jurisdiction so that fund managers in IFSC are at par with the fund management entities in competing foreign jurisdiction.
- **Proposed amendment in Section 9A:**
    - condition at clause (c) of sub-section (3) of section 9A is rationalised for all the eligible investment funds , whether or not their eligible fund managers are based in IFSC
    - Aggregate participation or investment in the fund is to be determined on April 01st or October 1st of the the previous year. In case condition is not satisfied on these dates, exemption will still be provided if the condition is satisfied within four months of the said days
    - Relaxation of conditions (a) to (m) (other than mentioned above) for a eligible investment fund where the date of commencement of operations by its eligible fund manager located in IFSC for the purposes of sub-section (8A) of section 9A is on or before 31st day of March, 2030.
- **Effective date** - 1st April, 2025

# Incentives to IFSC- ETFs under Relocation Regime (5/5)

- Following amendments have been proposed to include retail schemes and ETFs within the definition of resultant fund so that relocation of original funds to such funds in the IFSC is also a tax-neutral transaction
- Proposed to include such retail schemes or ETF within the definition of resultant fund for the purposes of clause (viiad) of section 47 of the Act
- **Effective date** - 1st April, 2026
- **Applicability** - AY 26-27 and subsequent assessment years

# AIFs (Categories I and II)

- AIFs form part of investment funds under the Income Tax Act and are governed by section 115UB.

- AIFs- Category I and II have been provided a pass-through status and therefore, all income (other than business income) is directly taxed in the hands of the unitholder.
    - Income treated as business income is taxed at the fund level.

- There was no provision/ clarity on treatment of income earned out of transfer of securities held by the AIF- whether the same will be business income or otherwise.

- Budget 2025 has clarified that such income will be treated as income from capital gains.
    - Definition of capital asset under section 2(14) to include securities held by such AIFs.

- Accordingly, such income will be taxed as capital gains in the hands of the unitholder.

- This is a positive move as it avoids the higher tax rates applicable on income classified as business income at the AIF level.

- While the industry had been nudging towards a similar pass-through status to category III AIFs as well, however, the Budget 2025 did not address this expectation.

# AIFs (Categories I and II)

Accordingly, income from investment in AIFs (Categories I and II ) shall be taxed in the following manner:

| **Nature of income** | **Tax liability** | **Rates** |
|---|---|---|
| Income arising from investments such as dividend, interest etc.<br>*[sec 115UB(1)]* | Unitholder | Slab rates |
| Business income<br>*[sec 115UB(4)]* | AIF | In case of a trust: Maximum marginal rate<br>In case of a company: 30%<br>In case of an LLP: 20% |
| Transfer of securities<br>*[newly added- change in section 2(14)]* | Unitholder | Capital gains<br>LTCG: 12.5% *(increased in Budget 2024)*<br>STCG: 20% *(increased in Budget 2024)* |

# Crypto-Asset - Definition & Tax Administration

- Section 2(47A) of tax code is proposed to be amended to include an additional definition of virtual digital assets. This definition is in line with that the CARF, i.e., the crypto-asset reporting format published by the OECD.
- Section 285BAA, proposed to be introduced, places obligations on persons, being reporting entities, to furnish information in respect of transactions in crypto-assets in a statement, for such period, within such time, in such form and manner and to such income-tax authority, as may be prescribed.

# High Level Committee for Regulatory Reforms

- A High-Level Committee for Regulatory Reforms is proposed to be set up
    - It shall carry out review of all non-financial sector regulations, certifications, licenses, and permissions.
- The objective as mentioned in the Budget Speech is to strengthen trust-based economic governance and take transformational measures to enhance '*ease of doing business*', especially in matters of inspections and compliances.
- The committee will be expected make recommendations within a year.
- Pursuant to the above, the existing corporate law regime is expected to be eased.

# Direct Tax

- Amendment proposed to introduce a scheme for determining arm's length price for international transactions for a block period of 3 years as an alternative to yearly examination for transfer pricing purposes.

- The amendment proposes to extend the benefit available u/s 80-IAC to start-ups by another five years, i.e. those incorporated before 1st April, 2030.

- Parity in rates of LTCG on transfer of securities by non resident.

- Increase in the period of validity of registration of trust or institution from 5 years to 10 years for smaller trusts or institutions.

- Amendment proposed in section 115UA of the Income-tax Act relating to tax on income of unit holder and business trust
    - Total income of a business trust shall be charged to tax subject to the provisions of sections 111A and 112 & 112A (Applicable from 1st April, 2026)

- Increase in tax rates for Foreign Institutional Investors under Section 115AD from 10% to 12.5%.

# TCS in case of LRS and education loan

- The threshold limit for TCS on remittances under RBI’s Liberalized Remittance Scheme (LRS) is proposed to be increased from Rs 7 lakhs to Rs 10 lakhs

- TCS on remittances for education purposes to be removed where such remittance is out of a loan taken from a specified financial institution

# Rationalisation of TDS limits (1/3)

**TDS** threshold limits has been proposed to be rationalised as follows  (Effective from 1st April. 2025)

| Section | Current Threshold | Proposed Threshold |
|---|---|---|
| 193-Interest on Securities | NIL | Rs 10,000 |
| 194-Payment of Dividend | Rs 5,000 | Rs 10,000 |
| 194A-Interest other than Interest on securities | • Rs 50,000 for senior citizen<br>• Rs. 40,000 in case of others when payer is bank cooperative society and PO<br>• Rs 5000 - other cases | • Rs 1,00,000 for senior citizens<br>• Rs 50,000 in case of others when payer is bank cooperative society and PO<br>• Rs 10,000 - other cases |

# Rationalisation of TDS limits (2/3)

| Section | Current Threshold | Proposed Threshold |
|---|---|---|
| 194K - Income in respect of units of a MF or specified Co or undertaking | Rs 5,000 | Rs 10,000 |
| 194J - Fee for professional or technical services | Rs 30,000 | Rs 50,000 |
| 194I- Rent | Rs. 2,40,000 during the financial year | Rs. 50,000 per month or part of a month |
| 194H - Commission or brokerage | Rs 15,000 | Rs 20,000 |
| 194LA - Payment on compensation on acquisition of certain immovable property | Rs 2,50,000 | Rs 5,00,000 |

# Rationalisation of TDS limits (3/3)

<table>
<tr><th>Section</th><th>Current Threshold</th><th>Proposed Threshold</th></tr>
<tr><td>194G - Income by way of commission, prize etc. on lottery tickets</td><td>Rs 15,000</td><td>Rs 20,000</td></tr>
<tr><td>194LBC - Income in respect of investment in securitization trust</td><td>● 25% if payee is Individual or HUF<br>● 30% any other person</td><td>Uniform rate of 10%</td></tr>
<tr><td>194D- Insurance Commission</td><td>Rs 15,000</td><td>Rs 20,000</td></tr>
<tr><td>194B - Winnings from lottery, crossword puzzle, etc</td><td rowspan="2">Aggregate of amounts Rs. 10,000 during the financial year</td><td rowspan="2">Rs. 10,000 in respect of a single transaction</td></tr>
<tr><td>194BB - Winnings from horse race</td></tr>
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