

Digital push, new accounting rules: Will Budget 2017 be a paradigm shift for Indian banks?

The traditional expectations in a Budget for the banking sector have been financial service reforms, tax breaks, deduction for NPA provisioning, reduction in tax rates, liberalisation in the FDI policy, etc. The upcoming 2017 Budget clearly is, however, expected to be a departure from the norm – let us see how.

In the past few months, India has gone through the demonetisation exercise, which has given a clear indication that the country is moving towards a cashless economy, which will curb the menace of black money. Everyone agrees that demonetisation is only the first step in the process – the next steps are likely to be unveiled in the Budget. A two-pronged approach clearly needs to be adopted by the government.

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For one, digital payments need to be incentivised – this can be done through policy changes, tax breaks for encouraging digital transactions, etc. Secondly, cash transactions need to be discouraged – the uppermost question in everyone's mind is that are we going to see the return of the banking cash transaction tax (or something similar)? The banking sector will be at the core of any such policy announcements and fintech will be at the heart of any measure of the government.

While on the subject of fintech, one needs to note that blockchain technology is a disruptive innovation that could transform the banking world. The Institute for Development and Research in Banking Technology, established by the RBI, has recently issued a whitepaper on blockchain for the banking and financial sector. The use of blockchain could throw up several tax issues, especially in relation to cross-border transactions, imports and indirect taxes.

Interestingly enough, the use of blockchain by tax authorities is also being discussed internationally. Closer home, the use of blockchain in the GST rollout later this year, could be worth examining.

On the regulatory reporting side, the Income Computation and Disclosure Standards (ICDS), which is in essence tax accounting standards, are applicable from 2016-17.

Accordingly, banks are required to maintain separate records where the ICDS is not in conformity with the RBI guidelines.

To compound the challenges for banks, although the new set of Indian Accounting Standards (Ind-AS) is proposed to be rolled out from 2018-19, banks are required to submit

proforma Ind-AS financial statements to RBI from 2016-17 itself. The implementation of Ind-AS for banks is likely to throw up several challenges on the tax front, especially in relation to transitional provisions (adjustments to reserves), minimum alternate tax, tax treatment of transactions, etc. Clarifications on various issues relating to Ind-AS are expected in the Budget.

Another important area that the government has been working on, is aligning the Indian tax system with the tax systems adopted internationally as a part of the G20 and OECD's base erosion and profit shifting (BEPS) project. This will kick-off in a big way with the general anti-avoidance rule (GAAR) being effective from financial year 2017-18. India is a supporter of the BEPS project and has also indicated that it will sign the multilateral instrument to amend its tax treaties in terms of the BEPS project.

The BEPS project has seen several large banks globally assessing the impact on its operations and tax positions (creation of permanent establishment, transfer pricing issues, interest deductions, etc.), although Indian banks have been a bit slow in looking at BEPS.

The Budget announcements on implementation of the BEPS actions, including possibly clarifications on GAAR, is likely to provide Indian banks (especially the ones operating globally), much needed clarity on the roadmap of the Indian government on BEPS.

To sum up, we have a power-packed Budget ahead of us with likely announcements relating to demonetisation, technology, GST, Ind-AS and BEPS, among others; a cut in the tax rates also appears very likely. This will mark a

paradigm shift for the banking industry as we await the futuristic Budget to be announced on 1 February.
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