Union Budget 2021

Implications on digital payments

March 2021

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Foreword

Dear readers,

It is my pleasure to bring to you the latest edition of PwC's Payments newsletter. In this edition, we have discussed our viewpoints on the announcements made during the presentation of Union Budget 2021–22 and their impact on the digital payments industry. We have analysed the potential allocation of INR 1,500 crore for the promotion of digital payments and initiatives that can be funded using this amount.

Additionally, we have also explored other sections in the budget that could have a direct or indirect impact on the digital payments industry, such as the development of a FinTech hub, focus on the micro, small and medium enterprise (MSME) sector and tax relaxation for start-ups.

I hope you will find this to be an insightful read.

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01
Union Budget 2021–22: Digital payments

Union Budget 2021–22: Digital payments

Introduction

Regulatory and government initiatives form the cornerstones of success in any digital payments ecosystem. In India, the Government's focus on providing adequate impetus to digital transactions has increased over the years. This is often visible through budgetary allocations towards digital payments and monitoring/promoting digital payments transactions at the central level.

Previous budgets and digital payments

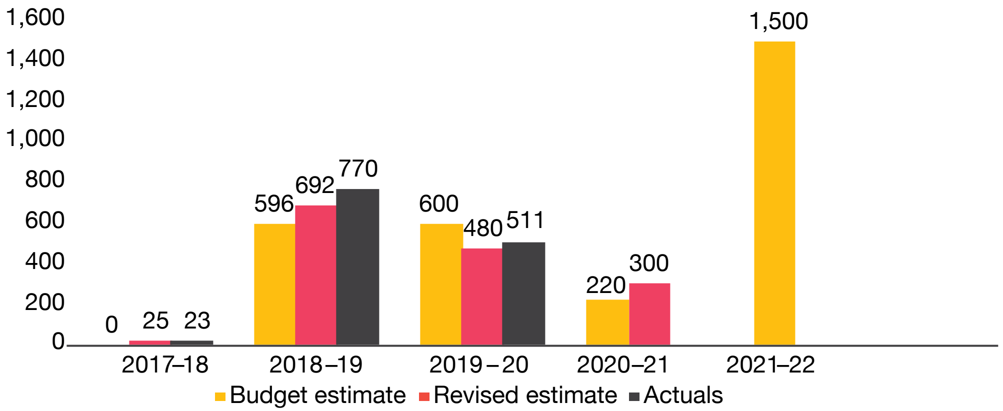
The Government of India (GoI) has focused significantly towards the growth of the digital payments ecosystem over the last few years. Budget announcements, direct budget allocations or indirect interventions like tax exemptions, caps on pricing structures, cashbacks and measures to discourage cash-based payments are some of the steps taken by the Government to encourage the expansion of digital payments.

The applicability of the merchant discount rate (MDR) is one of the key areas where the Government and the regulator (RBI) have intervened. The Reserve Bank of India (RBI) rationalised the MDR in 2017, based on a merchant's turnover. In 2019, the National Payments Corporation of India (NPCI) revised its RuPay MDR charges further in order to encourage the acceptance of digital payments. The Zero MDR initiative was announced in Union Budget 2019–20 and changed the face of the payments ecosystem.

There are other instances of budget initiatives that indirectly affected the digital payments ecosystem. It was announced in Union Budget 2019–20, that cash withdrawals exceeding INR 1 crore in a year were to be subjected to a tax deduction of 2%[1] at source in order to discourage cash-based business payments. In Union Budget 2020–21, the Government announced that it would increase the turnover threshold for the auditing of MSME accounts from INR 1 crore to INR 5 crore if 95% or more of their transactions were digital.[2] This was another step taken towards incentivising cashless transactions.

In terms of direct budget allocation for digital payments, the Government has been allocating funds for the Ministry of Electronics and Information Technology (MeitY) which in turn utilises these funds for the promotion of digital payments. The figure below shows the budget allocation towards MeitY for the promotion of digital payments over the last few years.

Budget allocations for digital payments (in INR crore)



Source: India Budget Expenditure Profile

1 https://www.businesstoday.in/union-budget-2019/news/budget-2019-govt-to-levy-2-tds-on-cash-withdrawal-exceeding-rs-1-crore-annually/story/361788.html

2 https://www.indiabudget.gov.in/doc/bspeech/bs202021.pdf

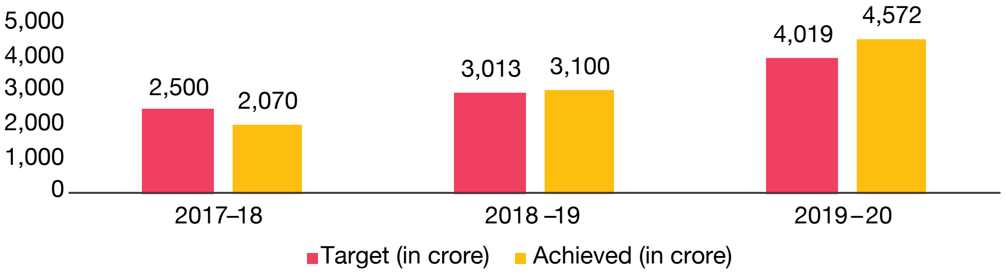
MeitY has utilised the allocated funds for various activities such as:

- conducting training sessions and workshops on digital payments awareness
- cashback schemes
- merchant incentive schemes
- promotion and awareness initiatives
- grants-in-aid.

Apart from taking the above-mentioned marketing and training initiatives, MeitY has been setting targets for banks and central ministries to increase the volume of digital transactions. This includes liaising with banks on a monthly basis to provide them reports on their current performance based on targets deployed, provision of scorecards, awards and incentives to be received on achievement of targets as well as constant collaboration with various ministries to improve the volumes of digital payments.

MeitY's consistent efforts have yielded sustainable results over the last two years, as depicted in the figure below:

Targets for digital payments volume (in INR crore)



Source: MeitY

Union Budget 2021 – digital payments

The COVID-19 pandemic and the growing affinity towards using contactless and online modes of payments resulted in a significant increase in the adoption of digital payments throughout 2020. It was announced in Union Budget 2021 that an amount of INR 1,500 crore would be allocated towards MeitY for the promotion of digital payments.

> "There has been a manifold increase in digital payments in the recent past. To give a further boost to digital transactions, I earmark INR 1,500 crores for a proposed scheme that will provide financial incentive to promote digital modes of payment.
>
> **Nirmala Sitharaman**
> **Union Minister of Finance**

Additionally, other initiatives like tax audit exemptions for businesses basis digital payments usage and the establishment of a FinTech hub were also announced.

02
Our point of view: Allocation of INR 1,500 crore



Our point of view: Allocation of INR 1,500 crore

The Government is yet to clarify how the allocated amount of INR 1,500 crore would be utilised towards boosting digital payments. MeitY and banks/payments industry players are engaging in discussions to get more clarity on how these funds could be utilised. This section outlines the key potential initiatives that could be funded by the allocated amount of INR 1,500 crore:

1. Compensation for revenue loss due to Zero MDR on UPI and RuPay

The Indian payments ecosystem went through significant changes in 2020, largely due to the Zero MDR policy announced by Finance Minister Nirmala Sitharaman in 2019.[3] The policy dictated that no MDR would be charged on Unified Payments Interface (UPI) and RuPay payment modes to promote the acceptance of digital payments among merchants.

The policy was intended to encourage the adoption of digital payments by smaller merchants by abolishing the MDR levied on them. However, it was also heavily contested by various players in the ecosystem, citing the loss of revenue as a major deterrent for optimal functioning of the industry. MDR accounts for a large source of income for acquirers who use it to pay interchange, switching and payment service provider (PSP) fees to other stakeholders. The absence of MDR could have a ripple effect on the viability and profitability of various players in the digital payments value chain.

As per PwC's analysis and calculations, the total revenue loss due to Zero MDR was around INR 1,450–1,500 crore for UPI person-to-merchant (P2M) payments and ~INR 1,000–1,200 crore for RuPay payments in 2020. Approximately 30-35% of this MDR loss was accounted for small value transactions of value less than INR 2000. The majority of the losses were borne by acquirers, PSPs and issuers.

There have been some interim relaxations on interchange and PSP fees for UPI P2M transactions and industry players have also devised newer ways to compensate for the losses incurred (such as merchant annual charges, higher settlement timelines to increase float, focusing on value-added services for merchants, etc.). However, the larger effects of revenue loss persist, especially with the downstream outcomes on employment, innovation and expansion of the digital payments industry.

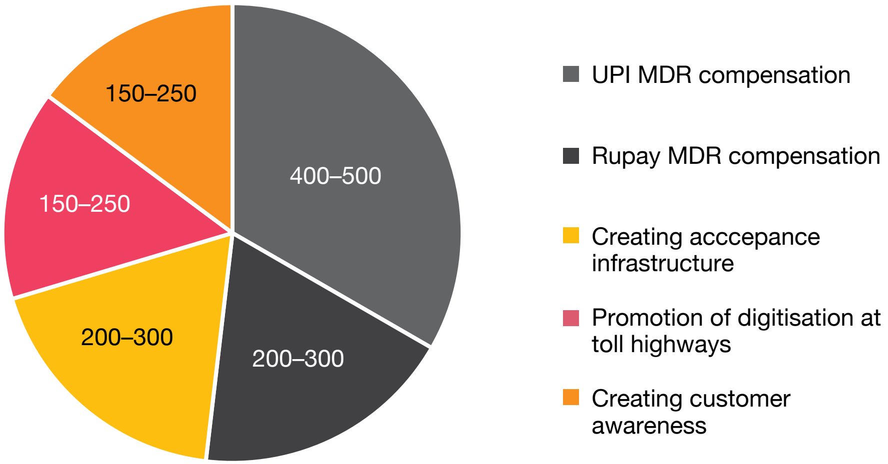
It is likely that a majority of the INR 1,500 crore earmarked for digital payments would be allotted towards compensating for the losses incurred by the industry due to the Zero MDR policy. There have been previous instances of compensating for losses when MeitY reimbursed the MDR charges on debit card, BHIM UPI and Aadhaar Enabled Payment System (AePS) transactions worth less than or equal to INR 2,000 for a period of two years from 1 January 2018–December 2019.[4] This incentive promoted digitisation and reduced the burden on banks to set up acquiring infrastructure.

3 https://www.thehindubusinessline.com/opinion/columns/slate/all-you-wanted-to-know-about-the-zero-mdr-issue/article30559534.ece

4 https://financialservices.gov.in/sites/default/files/Subsidizing%20MDR%20by%20Govt.pdf

If the Government focuses on compensating for Zero MDR for both UPI and RuPay transactions below INR 2,000, then the total amount to be compensated would be around INR 600–800 crore. The INR 1,500 crore outlay can can be utilised for this purpose.

Potential budget allocation (expenditure of INR 1,500 crore)



Source: PwC analysis

2. Setting up merchant-acceptance infrastructures for digital payments

The Government could also consider allocating funds for setting up digital payments acceptance infrastructures, especially for the MSME segment and rural areas.

The Payment Infrastructure Development Fund (PIDF) has already been set up by the RBI with a corpus of approximately INR 345 crore. The PIDF is being used to install up to one million physical point of sale (PoS) and three million digital PoS machines in rural India (tier 3–6 cities).[5] However, there is substantial scope for further investments to promote the acceptance infrastructure in the country. There are approximately 63 million MSMEs in India, with around 99% of them under the 'micro' segment and 51% of them in rural regions.[6] The current acceptance infrastructure of 8.6 million digital acceptance points (5.8 million PoS machines and 2.8 million Bharat QR acceptance points as of December 2020[7]) account for only around 13% of the potential acceptance points in the country. Thus, the Government could consider allocating additional funds worth INR 200–300 crore to promote digital payments beyond the PIDF scheme's targets.

3. Encouraging digital payments for toll collection

FASTag – the National Highways Authority of India's (NHAI) electronic toll collection system – is another great initiative by the Government to promote digital payments in toll-collection booths. Currently the NHAI is paying an MDR of 3–4% on FASTag collection which is way higher than the majority of the other payments modes, including cards (with an MDR of 0.5–2%). A total of INR 196 billion was collected through FASTag in 2020, out of which MDR accounted for INR 600–800 crore.[8]

Typically, the issuer, NPCI and IHMCL (Indian Highway Management Company Limited) receive their fixed shares from the FASTag MDR, i.e. 1.5%, 0.25% and 1% respectively, and the acquirer receives its share following a bidding process that caps the amount at 1.25%.[9] The toll industry has witnessed a decrease in MDR up to 2.5–3% and acquirers have to bear the majority of the losses, with bidding as low as 0.3%. Thus, acquirers can be compensated up to 0.5% of the toll collection for promoting FASTag adoptions, amounting to approximately INR 100 crore.

5 https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12009&Mode=0

6 https://msme.gov.in/sites/default/files/MSME-ANNUAL-REPORT-ENGLISH%202020-21.pdf page:28

7 http://rbi.org.in/scripts/ATMView.aspx

8 https://www.npci.org.in/what-we-do/netc-fastag/product-statistics

9 https://economictimes.indiatimes.com/opinion/interviews/fastag-mobility-cards-big-focus-for-us-this-year-npci-coo/articleshow/70550013.cms?from=mdr

Further, the Government may also allocate funds to promote the adoption of FASTags in state highways and other use cases such as parking and fuel payments. As of February 2021, only 112 state highways were digitised with FASTags.[10] If state governments target to install FASTags on approximately 500 state highways and assuming INR 30 crore is collected from each highway in a year, around INR 15,000 crore would be added to the total toll collection. Therefore, if acquirers are compensated 0.5% of the toll collection to achieve the target of 500 tolls, the Government can allocate approximately INR 75–100 crore for promoting the digitisation of toll collection on state highways.

4. Investing in marketing, awareness and innovation

Marketing and awareness campaigns by the Government and the industry are the key pillars for encouraging digital payments initiatives in the country. Given that the industry has spent more than INR 2,000 crore on the promotion of digital payments and incentives to improve uptake over the last two–three years,[11] it could be expected that a marginal share of 5–10% of the Government's INR 1,500 crore expenditure may be allocated for campaigns such as:

- awareness campaigns (run by MeitY in conjunction with various other entities like the NPCI, Ministry of Road Transport and Highways, Ministry of Power, women-led self-help groups and more) like product roadshows in rural areas and digital literacy programs
- the development of a centralised and unified platform that enhances customer awareness to prevent and reduce overall digital payments fraud, and provides information on various digital payments modes available in the country and associated regulations about their limits, incentives, usage instructions, etc.
- advertisements highlighting the advantages of digital payments
- initiatives to encourage more tech start-ups to create simpler products in multiple languages to improve access.

10 https://timesofindia.indiatimes.com/business/india-business/most-state-highways-yet-to-go-for-payments-through-fastags/articleshow/81101549.cms

11 https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/ANALYSISQRCODED11971A9B9874EAFA1A61478F461E238.PDF

03 Other budget announcements and their impact

Other budget announcements and their impact

Multiple announcements other than the allocation of INR 1,500 crore were made during the presentation of Union Budget 2021 to boost the digital payments ecosystem in the country.

Fintech Hub at GIFT-IFSC

"The Government would support the development of a world class FinTech hub at the GIFT-IFSC."

The Government's support in developing a FinTech hub in Gujarat International Finance Tec-City (GIFT), Gandhinagar, would allow smaller digital payments technology firms to access better funding initiatives and provide them with a platform to explore and innovate more cost-efficient and easily adaptable financial products.

Focus on MSMEs

"We have taken a number of steps to support the MSME sector. In this Budget, I have provided INR 15,700 crores to this sector, more than double of this year's BE."

"I propose to revise the definition under the Companies Act, 2013 for Small Companies by increasing their thresholds for Paid up capital from "not exceeding INR 50 Lakh" to "not exceeding INR 2 Crore" and turnover from "not exceeding INR 2 Crore" to "not exceeding INR 20 Crore".

- The provision of INR 15,700 crore to the MSME sector could prove to be beneficial for financial inclusion, especially since approximately 51% MSMEs are in rural regions.
- Once the number of such MSMEs comes under the aegis of digitisation, they can be leveraged as a target market for asset-light acquiring solutions.
- The revised definition of small enterprises would help in the easing of compliance requirements for such entities and allow them to focus on modernisation initiatives, including digitisation of transactions.

Relaxations on audit rules

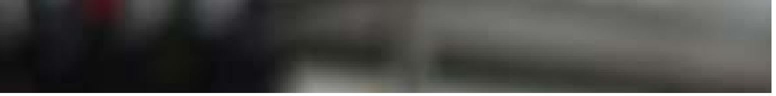
"In the February 2020 Budget, I had increased the limit for tax audit to INR 5 crore for those who carry out 95% of their transactions digitally. To further incentivize digital transactions and reduce compliance burden, I propose to increase this limit for tax audit for such persons from INR 5 crore to INR 10 crore"

- This move aims to reduce the audit burden on companies with a turnover of less than INR 10 crore (previously INR 5 crore) by promoting the use of digital payments modes.
- This in turn brings more small businesses into the ambit of the audit-free initiative and incentivises digital-usage behaviour at the grassroots level.

Tax relaxations for start-ups

"In order to incentivise start-ups in the country, I propose to extend the eligibility for claiming tax holiday for start-ups by one more year – till 31st March 2022. Further, in order to incentivise funding of the start-ups, I propose to extend the capital gains exemption for investment in start-ups by one more year - till 31st March 2022".

- With the Government's Aatmanirbhar Bharat (self-reliant India) initiative, the payments industry is looking at developing more innovative solutions that can improve the reach and access of digital solutions, including digital payments.
- Technology start-ups form the cornerstone of such digital payments innovation and these exemptions would allow them to better finance cost-effective payments solutions without incurring additional tax burdens as well as ensuring that more investments and funding are secured.



04
Conclusion

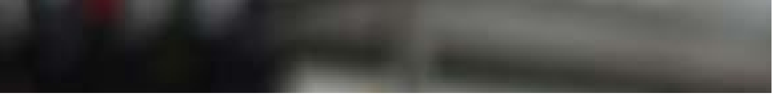
Conclusion

Announcements made during the presentation of Union budget 2021 will strengthen the digital payments ecosystem in India. However, the industry may require further Government impetus to harness its true growth potential.

The allocated amount of INR 1,500 crore may be able to compensate for small-ticket MDR losses but further funds may be required to compensate for losses incurred in large-ticket transactions (greater than INR 2,000). In terms of the PIDF, while the regulator is targeting to set up three million acceptance points, there remains a large gap with approximately 30 million MSMEs in rural regions that could benefit from digitisation. Multiple other targeted schemes across the transit sector, Government payments, financial inclusion, etc., can also benefit from Government funding. Consequently, there is scope for increasing the budget allocation for digital payments in order to provide requisite support to the ecosystem. The Union budget could have considered allocating an amount of INR 3,500–4,000 crore to address various issues, including MDR compensations for large-ticket transactions, setting up of digital infrastructures, digitisation of state tolls and other targeted initiatives.

The Union budget announcements like audit relaxations, the development of a FinTech hub, focus on MSMEs and relaxations for start-ups indirectly impact the digital payments ecosystem and are steps in the right direction. Such measures could bring more players under the digital payments umbrella while fostering much-needed innovation. In the coming years, more such initiatives focused on small and young businesses could help the ecosystem achieve its full potential.

The allocation of INR 1,500 crore is a welcome move that could bring about important changes in the industry and sets the stage for more such initiatives to be launched in the future.



05
Payments technology updates

Payments technology updates

Axis Bank launches India's first wearable contactless payment devices at₹750

Live Mint

Axis Bank has launched 'Wear N Pay' devices like bands, key chains and watch loops. These wearable devices can be worn easily to carry out contactless transactions on the go.

Read more.

RBI extends due date for NPCI-rival NUE

The Times of India

The RBI has extended the deadline for submitting applications to set up a new umbrella entity (NUE) in the payments system that will rival the National Payments Corporation of India (NPCI). Earlier, interested parties were to submit their application by February 26, which has now been extended to March 31.

Read more.

Union budget 2021: ₹1,500 crore scheme to boost digital payments

Hindustan Times

Top payment executives have said in the past that lack of monetization around digital payments in the country is stifling innovation and investments in the space.

Read more.

RBI issues master direction to ensure security of digital payments

Business Standard

The Reserve Bank came out with a Master Direction for banks and card-issuing entities laying down common minimum standards to ensure security of digital payments.

The Master Direction lays down guidelines for internet banking, mobile payments, card payments, customer protection and grievance redressal mechanism.

Read more.

Paytm to apply for New Umbrella Entity in consortium with Ola

Mint

The Reserve Bank came out with a Master Direction for banks and card-Paytm is applying for NUE (New Umbrella Entity) in a consortium with players including ride hailing platform Ola, as part of its efforts to develop more innovative and inclusive digital payments solutions for the Indian population.

Read more.

Six consortiums apply to RBI for NUE licence for retail payments

Economic Times

Six consortiums, including those led by Reliance Industries, Tata Group and Axis-ICICI Bank, submitted applications to the central bank on Wednesday to set up a national payments infrastructure rivalling the National Payments Corp of India (NPCI) platform.

The other consortiums are led by Paytm, India Post and Fintech startup iserveU.

Read more.

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Data Classification: DC0 (Public)

SG/April 2021 - M&C 11856