BUDGET 2014 NEWS FLASH - KEY PROPOSALS CONCERNING FOREIGN INVESTMENTS IN INDIA

In his maiden Budget speech, the Finance Minister Mr. Arun Jaitley ushered in a policy regime that will result in the desired macro-economic outcome of higher growth, lower inflation, sustained level of external sector balance and a prudent policy stance. He mentioned that the steps announced in this Budget would initiate a journey towards a sustained growth of 7-8 per cent or above within the next 3-4 years along with macro-economic stabilization that would include a manageable current account deficit.

The present NDA Government is of the view that "One fails only when one stops trying". Hence, though the current target of reducing fiscal deficit to 4.1 per cent in itself is daunting, the road map of the Government for fiscal consolidation is a fiscal deficit of 3.6 per cent for 2015-16 and 3 per cent for 2016-17. Inspite of the Iraq crisis leaving an impact on oil prices and volatility in the middle-east and the unpredictable monsoon at India, there has been a gradual moderation in WPI recently, from a high of 7.35% in 2012-13 and 5.98% in 2013-14. The Government has assured to undertake some bold steps in order to enhance economic activity and spur growth in the economy.

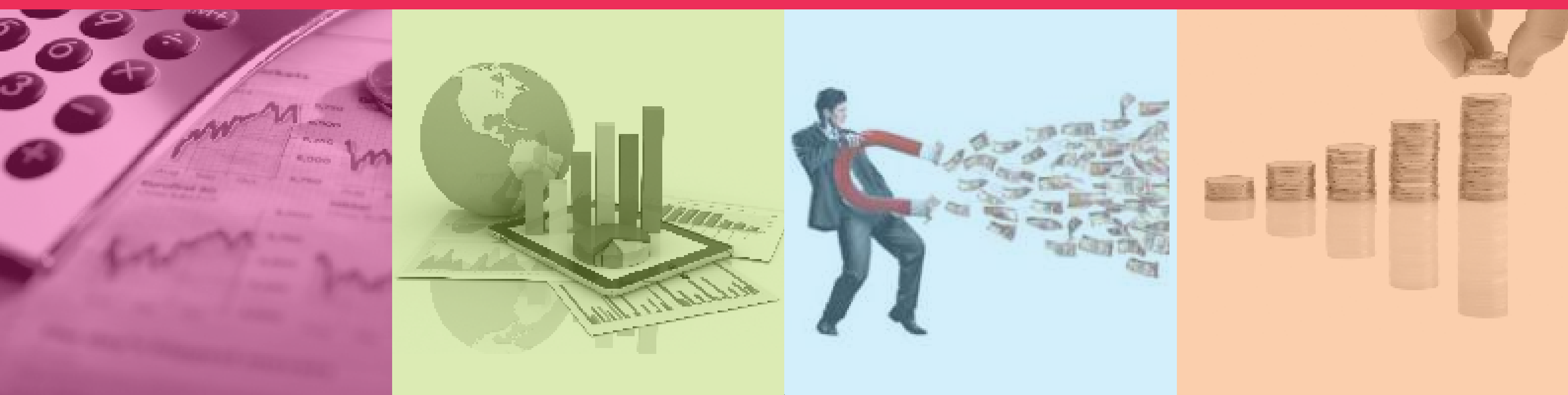
Summary of few of the announcements, which are directly aimed to boost sentiments and confidence of foreign investors, are provided below:-

Policy announcements

- Foreign Exchange Regulations

  The applicable cap/ restriction on Foreign Direct Investment (F.D.I.) in few key identifiable sectors were proposed to be further liberalized

Sector	Liberalization
Defence	Increased from 26 percent to 49 percent through FIPB route with full management and control.
Insurance	Increased from 26 percent to 49 percent through FIPB route with full management and control.
Manufacturing companies	Allowed to sell its product through retail including e-commerce
Real Estate	Requirement of minimum built up area of capital conditions is reduced from 50,000sq. mt. to 20,000sq. mt. Investment reduced from USD 1 million to USD 5 million with 3 year post completion lock in. Projects which expend minimum 30 per cent in low cost affordable houses will be exempted from minimum built up area with condition of 3 year post completion lock in.



- Real Estate Investment Trust (REIT) & Infrastructure Investment Trusts (InvITs)

  Real Estate Investment Trusts (REIT) have been successfully used as instruments for pooling of investment in several countries. Taking cue from the same, Government of India has announced the intention to introduce the same for Indian Markets.

  REIT would be given a tax pass-through status to avoid double taxation. A 'pass-through' status means that the income generated would be taxed in the hands of the investor, and that the fund itself would not have to pay taxes on the same.

  A modified REIT type structure for infrastructure projects has also been announced as Infrastructure Investment Trusts (InvITs), which would have a similar tax efficient pass through status, for PPP and other infrastructure projects. These two instruments would be a lucrative investment option for foreign investors including the NRIs.

- Foreign Portfolio Investors (FPIs)

  In an attempt to boost confidence of FPIs & bring about desired tax certainty, several amendments have been introduced in the finance bill to provide clarity on the characterization of income of FPI from portfolio investments in Indian stock market. Foreign Portfolio Investors (FPIs) have currently invested more than Rs 8 Lakh crore (about 130 billion USD) in India.

Direct Tax Proposals:

- No change to the existing income tax rates.

- Indirect transfers

  Whilst no change has been proposed to be carried out to the law, in an attempt to gain confidence of the foreign investors, it has been proposed that all fresh cases arising out of the retrospective amendments of finance bill of 2012, in respect of indirect transfers, and coming to the notice of the Assessing Officers, shall be scrutinized by a High Level Committee (to be constituted by the Income Tax Authorities) before any action is initiated in such cases. This measure has been proposed with an endeavor to send out signal to the foreign investors that the government is committed to provide a stable and predictable taxation regime that would be investor friendly and spur growth.

- Transfer Pricing

  To address to the one of the most important concerns of the foreign investors on the subject of tax litigation arising through transfer pricing adjustments, several changes and amendments have been proposed to the transfer pricing regulations. Provisions have been inserted/amended to (a) strengthen the administrative set up of APA to expedite disposal of application, (b) introduce Roll Back provisions to take cognizance of transactions of previous years, (c) introduce range concept for determination of arm's length price and (d) allow to use comparable analysis of multiple year.

- <u>Foreign Currency Borrowings</u>

  In order to augment low cost long term foreign borrowings for Indian companies, the eligible date of borrowing in foreign currency has been extended from 30 June 2016 to 30 June 2017 for a concessional tax rate of 5 percent on interest payments, on all types of bonds instead of only infrastructure bonds, to enable the companies to step up their investments in India.

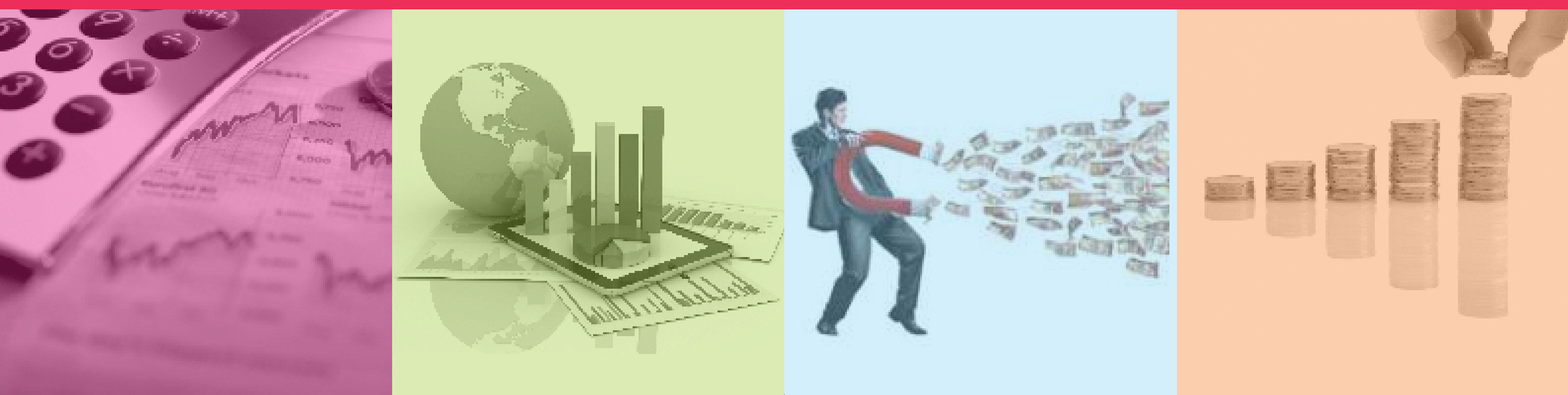
- <u>Characterization of income earned by Foreign Portfolio Investor (FPI)</u>

  It is proposed to amend the law to treat any security held by the FPI as a 'capital asset' resulting that any income arising from transfer of such 'capital asset' by FPI would be characterized as 'capital gain'.

- <u>Real Estate Investment Trust (REIT)</u>

  New provisions have been proposed to be introduced in the law that would provide the broad structure for the operation of the REIT and InvIT as well as proposed taxation regime for the trust and investors. The summary of the same is as under:

  i. The Trust would raise capital by way of issue of units (to be listed on a recognized stock exchange) and can also raise debts directly both from resident as well as non-resident investors;
  ii. The income bearing assets would be held by the trust by acquiring controlling or other specific interest in an Indian company (SPV) from the sponsor;
  iii. The taxation regime for such 'business trust' would be as follows:
     - Long Term Capital Gains would be exempt and Short Term Capital Gains would be taxable at the rate of 15%.
     - In case of capital gains arising to the sponsor after transfer at the time of exchange of shares in SPVs with units of the business trust, the taxation of gains shall be deferred and taxed at the time of disposal of units by the sponsor.
     - However, the preferential capital gains regime (consequential to levy of STT) available in respect of units of business trust will not be available to the sponsor in respect of these units at the time of disposal. Further, for the purpose of computing capital gain, the cost of these units shall be considered as cost of the shares to the sponsor. The holding period of shares shall also be included in the holding period of such units.
     - The income by way of interest received by the business trust from SPV is accorded pass through treatment i.e., there is no taxation of such interest income in the hands of the trust and no withholding tax at the level of SPV. However, withholding tax at the rate of 5 percent in case of payment of interest income distributed to non-residents and at the rate of 10 percent in respect of payment of interest income to a residents hall be effected by the trust.
     - In case of external commercial borrowings by the business trust, the benefit of reduced rate of 5 per cent tax on interest payments to non-resident lenders shall be



available on similar conditions, for such period as is provided in section194LC of the Act.

- ❖ The dividend received by the trust shall be subject to dividend distribution tax at the level of SPV but will be exempt in the hands of the trust, and the dividend component of the income distributed by the trust to unit holders will also be exempt.
- ❖ The income by way of capital gains on disposal of assets by the trust shall be taxable in the hands of the trust at the applicable rate. However, if such capital gains are distributed, then the component of distributed income attributable to capital gains would be exempt in the hands of the unit holder. Any other income of the trust shall be taxable at the maximum marginal rate.
- ❖ The business trust is required to furnish its return of income.

- <u>TDS Deduction Due Date Extended for Payments to Non-Residents</u>
  In order to provide extended time limit for deposit of tax deducted from payments made to non-residents, it is proposed that the deductor shall be allowed to claim deduction for payments made to non-residents in the year of payment of income, if tax so deducted during the year is deposited on or before the due date specified for filing of return for the deductor under section 139(1) of the Act.

- <u>Transfer of Government Securities by Non- Residents</u>
  It has been proposed to insert a new clause (viib) under Section 47 so as to provide that any gain arising to a non-resident from the transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India through an intermediary dealing in settlement of securities, to another non-resident shall not be subject to tax in India.