BUDGET 2016 NEWS FLASH-KEY PROPOSALS CONCERNING FOREIGN INVESTMENTS IN INDIA

Indian Finance Minister Shri. Arun Jaitley presented his second full Budget for 2016-17 today. The focus was on boosting the rural economy, higher spending in the sector to fire demand, announcing new rural aid and health programmes. Affirming that the economy is right on track he laid the foundation of transforming the nation with 'nine pillars' including tax reforms, promoting ease of doing business and ensuring fiscal. He proposed a Pro-Poor, "Pro-Make In India" budget and exempted start-ups from income tax for 3 years. The Finance Minister reiterated a forecast that India would grow by 7.6 percent in the fiscal year that is drawing to a close.

The government wanted to spread the benefits of growth more widely among India's 1.3 billion people, but that it would stick to the existing fiscal deficit target for the coming year. FDI policy in several sectors, including insurance and pension and asset reconstruction companies are once again relaxed, to attract more overseas investments.

Some of the announcements concerning foreign investors are summarized below:

1. Foreign Exchange Regulations

- Foreign Direct Investment (FDI)
  - ❖ Foreign investment will be allowed in the insurance and pension sectors in the automatic route up to 49% subject to the extant guidelines on Indian management and control to be verified by the Regulators.
  - ❖ 100% FDI in Asset Reconstruction Companies (ARCs) will be permitted through automatic route.
  - ❖ Foreign Portfolio Investors (FPIs) will be allowed up to 100% of each tranche in securities receipts issued by ARCs subject to sectoral caps.
  - ❖ 100% FDI will be allowed through FIPB route in marketing of food products produced and manufactured in India
  - ❖ Investment limit for foreign entities in Indian stock exchanges will be enhanced from 5 to 15% on par with domestic institutions. This will enhance global competitiveness of Indian stock exchanges and accelerate adoption of best-in-class technology and global market practices.
  - ❖ The existing 24% limit for investment by FPIs in Central Public Sector Enterprises, other than Banks, listed in stock exchanges, will be increased to 49% to obviate the need for prior approval of Government for increasing the FPI investment.

- ❖ FDI instruments will be expanded to include hybrid instruments subject to certain conditions.
- ❖ FDI will be allowed beyond the 18 specified NBFC activities in the automatic route in other activities which are regulated by financial sector regulators.
- ❖ With a view to promote Make in India and following the practices in advanced countries, foreign investors will be accorded Residency Status subject to certain conditions
- ❖ In order to ensure effective implementation of Bilateral Investment Treaties signed by India with other countries, it is proposed to introduce a Centre State Investment Agreement.

- Foreign Contribution (Regulation) Act, 2010
    - ❖ It is proposed to amend Foreign Contribution (Regulation) Act, 2010 to insert the provision that where the nominal value of share capital is within the limits specified for foreign investment under the Foreign Exchange Management Act, 1999, or the rules or regulations made there under, then, notwithstanding the nominal value of share capital of a company being more than one-half of such value at the time of making the contribution, such company shall not be a foreign source.

2. Direct Tax proposals

- An increase of 3 per cent in Surcharge Rates in the case of a non-resident person (other than a company). Further no change to the existing income tax rates for foreign companies.
- Base Erosion and Profit Shifting (BEPS)
    - ❖ For implementation of BEPS Action 13, which is the minimum standard to be followed by every member/partner country it is proposed to provide for furnishing of documents by the specified person. This amendment would take place w.e.f. 01st April 2017.
    - ❖ Companies with consolidated revenue of more than Euro 750 million are required to comply with country by country reporting.
    - ❖ Equalization Levy
        - ▪ In order to meet the tax challenges faced for implementation of BEPS Action 1, it is proposed to insert a new Chapter titled "Equalization Levy" @ 6 % of

the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment ('PE') in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

- It is proposed to provide for the procedure to be adopted for collection and recovery of equalization levy.
- No such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed one lakh rupees in any previous year.
- In order to ensure effective compliance, it also proposes to provide for interest; penalty and prosecution in case of defaults with sufficient safeguards.
- In order to avoid double taxation, it is proposed to provide exemption under section 10 of the Act for any income arising from providing specified services on which equalization levy is chargeable.
- It is further proposed to provide that the expenses incurred by the assessee towards specified services chargeable under this Chapter shall not be allowed as deduction in case of failure of the assessee to deduct and deposit the equalization levy to the credit of Central government.
- This Chapter will take effect from the date appointed in the notification to be issued by the Central Government.
- It is proposed to insert new section 115BBF where the total income of the eligible assessee income includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of ten per cent (plus applicable surcharge and cess) on the gross amount of royalty. No expenditure or allowance in respect of such royalty income shall be allowed under the Act. These amendments will take effect from 1st April, 2017.

- International Financial Services Centre.
  - ❖ In order to incentivize the growth of International Financial Services Centers into a world class financial services hub in India; it is proposed to make necessary

amendment to the relevant sections of the Income Tax Act, 1961 to provide the following tax benefits.

- The companies located in international financial services centre shall not be liable to dividend distribution tax.
- Minimum Alternate Tax shall be charged at the rate of nine per cent from units located in international financial services centre.
- It is also proposed that the gains arising from transfer of such long term capital asset shall be exempt from tax.
- The above amendments would take place w.e.f. 01st April 2017.
- The transaction in foreign currency of sale of equity shares or units of equity oriented funds or units of a business trust taking place on a recognised stock exchange established in international financial services centre shall not be liable to securities transaction tax. This amendment would take place w.e.f. 01st June 2016.
- The transaction in foreign currency of sale of commodity derivatives taking place on a recognised association established in international financial services centre shall not be liable to commodity transaction tax. This amendment would take place w.e.f. 01st June 2016.

- Real Estate Investment Trusts (REITs)
  - ❖ It is proposed that any distribution made out of current income of SPV to the REITs and INVITs having specified shareholding will not be subjected to Dividend Distribution Tax subject to conditions as prescribed. This amendment would take place w.e.f. 01st June 2016.
- Residential Status
  - ❖ It has been proposed to defer the determination of residency of foreign company on the basis of Place of Effective Management (POEM) by one year.
  - ❖ It has been proposed to amend the provisions of section 6 to provide that a person being a company shall be said to be a resident in India if its place of effective management (POEM) at any time, is in India. It is proposed to define the Place of Effective management to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are in substance made. This amendment would be effective from 01st April 2017.

- It has been proposed to provide a transition mechanism for foreign companies which would be resident in India as per definition of POEM.

- Minimum Alternate Tax (MAT) Provisions for Foreign Companies for the period prior to 01st April 2015
    - It has been proposed to amend the provisions of Section 115 JB to provide that Minimum Alternate Tax (MAT) shall not be applicable to a foreign company, w.e.f. 01.04.2001 if the foreign company does not have as a permanent establishment under relevant Double Taxation Avoidance Agreement (DTAA) or a place of business in India.
    - It has also been proposed to extend DTAA benefits by allowing for rate in force being applicable for withholding tax purposes in respect of distribution by Category-I and II Alternate Investment Funds to the non-resident investors.
    - It is also proposed to provide that the non-resident investors may seek certificate of lower deduction or nil deduction of tax. This amendment would take place w.e.f. 01st June 2016.

- Extension of time limit to pass orders by Transfer Pricing Officers
    - It has been proposed to extend section 92 CA (3A) to provide extension up-to sixty days, if the period of limitation available to the Transfer Pricing Officer for making an order is less than sixty days, to make an order where assessment proceedings are stayed by any court or where a reference for exchange of information has been made by the competent authority. This amendment would take place w.e.f. 01st June 2016.

- Dividend Distribution Tax (DDT)
    - It has been proposed , that in addition to DDT paid by the companies, tax at the rate of 10% of gross amount of dividend will be payable by the recipients, i.e., individuals, HUFs and firms receiving dividend in excess of Rs 10 lakh per annum. This amendment would take place w.e.f. 01st April 2017.
    - The companies located in international financial services centre shall not be liable to dividend distribution tax.
    - It is proposed that any distribution made out of income of SPV to the REITs and INVITs having specified shareholding will not be subjected to Dividend Distribution Tax. This amendment would take place w.e.f. 01st June 2016.

- Permanent Account Number (PAN)
    - In order to reduce the compliance burden, it has been proposed to amend section 206 AA, so as to provide that the provisions of this section shall also not apply to a non-resident, not being a company, or to a foreign company, in respect of any other payment, other than interest on bonds, subject to such conditions as may be prescribed.
    - This amendment would take place w.e.f. 01st June 2016.
- It is proposed to insert a new clause (e) in the Explanation 1 to clause (i) of Section 9 (1) so as to provide that in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India through or from the activities which are confined to the display of uncut and unassorted diamond in any special zone notified by the Central Government in the Official Gazette in this behalf. This amendment will take effect retrospectively from 1st April, 2016.
- It is proposed to amend the provisions of section 10 of the Act to provide that any income accruing or arising to a foreign company on account of storage of crude oil in a facility in India and sale of crude oil there from to any person resident in India shall not be included in the total income, on fulfillment of certain prescribed conditions. This amendment will be effective from 1st April, 2016.
- It is proposed to amend Section 194 LBB to provide that the person responsible for making the payment to the investor shall deduct income-tax 194LBB at the rate of ten per cent where the payee is a resident and at the rates in force where the payee is a non-resident (not being a company) or a foreign company. It is further proposed to obtain lower deduction tax certificate u/s. 194 LBB. This amendment will be effective from 01st June 2016.
- Rupee Denominated Bond
    - Indian corporate have been permitted by Reserve Bank of India , recently to issue rupee denominated bonds outside India as a measure to enable the Indian corporates to raise funds from outside India. In order to provide relief to the non-resident investor it is proposed to amend section 48 of the Act so as to provide that the capital gains, arising in case of appreciation of rupee between the date of issue and the date of redemption against the foreign currency in which the investment is made shall be exempt from tax on capital gains.
    - This amendment will be effective from 01st April 2017.

- Sovereign Gold Bond Scheme, 2015
  - It is proposed to amend Section 47 to exempt from tax on capital gains arising on redemption of Sovereign Gold Bond under the Sovereign Gold Bond Scheme, 2015.
  - It is also proposed to Section 48 to provide indexation benefits to long terms capital gains arising on transfer of Sovereign Gold Bond to all cases of assessees.
  - This amendment will be effective from 01st April 2017.
- Make in India Programme
  - It is proposed to promote start ups through the following measures:
    - 100% deduction of profits for 3 years out of 5 years for those set up during April 2016 to March 2019. Minimum Alternate Taxes shall apply to the start-ups for the three years.
    - Capital gains will not be taxed if invested in regulated/notified Fund of Funds and by individuals in notified startups, in which they hold majority shares.
    - Foreign investors to be allotted residential status, subject to prescribed conditions.
- Deduction for Units Established in Special Economic Zones
  - It is proposed to amend section 10AA of the Income-tax Act to provide for a sunset date of 31.03.2020 for commencement of activity of manufacture or production of any article or thing or providing services by a unit located in a Special Economic Zone for availing the deduction under said section. This amendment will be effective from 01st April 2017.
- It is proposed to reduce the period from three years to two years for getting benefit of long term capital gain regime in case of unlisted companies.
- It is proposed to amend Section 112 (1) (c) so as to provide that long-term capital gains arising from the transfer of a capital asset being shares of a company not being a company in which the public are substantially interested, shall be chargeable to tax at the rate of 10 per cent. This amendment will be effective from 01st April 2017.
- It is proposed to exempt any transfer of units in merger or consolidation of plans of a mutual fund scheme from capital gains. This amendment will be effective from 01st April 2017.
- It is proposed to provide that interest earned on Deposit Certificates issued under Gold Monetisation Scheme, 2015 and capital gains arising from them shall be exempt from tax. This amendment will be effective from 01st April 2017.