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BUDGET 2016

Understanding the Business Impact

Impact on Foreign Portfolio Investors (FPIs)

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The Finance Minister presented the Union Budget for the fiscal year 2016-17 in the parliament on 29 February, 2016. Key highlights of the Budget proposals impacting Foreign Portfolio Investors (FPIs) are summarized below:

Tax Proposals

- Increase in rate of Securities Transaction Tax (STT) on sale of Options from 0.017% to 0.05% of the option premium amount.
Impact – The increase in STT rate increases transaction cost for options trading and particularly impacts market makers and high frequency traders.
- Increase in surcharge from 12% to 15% on the tax rate for non-corporates FPIs whose taxable income exceeds INR 10 million.
Impact - The increase in surcharge will impact non-corporate FPIs such as trusts, partnerships etc. As an example, the effective tax for a non-corporate FPI on short term capital gains from sale of listed shares would be 17.7675% provided the total taxable income is more than INR 10 million.
- Relaxations in conditions to be fulfilled by Fund Managers in India for not constituting business connection (akin to or Permanent Establishment) in India:
 - In addition to funds based in tax treaty countries, the exemption would also be available to funds based in other countries as may be notified by the Government
 - The words “from India” in the condition that “the fund shall not carry on or control and manage, directly or indirectly, any business in India or from India” have been removed**Impact** – While these relaxations are welcome, the other onerous conditions to be met by the fund as well as fund manager still remain.
- Long Term Capital Gains (LTCG) period for unlisted companies to be reduced from 3 years to 2 years.
Impact – The Finance Minister in his budget speech announced that the holding period of unlisted companies for deciding the long term / short term nature of capital gains would be reduced



from existing 3 years to 2 years. However, this change has not been included in the proposed tax amendments in Finance Bill, 2016.

- Clarification that the tax rate on long term capital gains earned from sale of unlisted securities and shares of company other than company in which public are substantially interested to be 10%
Impact – This amendment has been introduced to address the controversy that the 10% tax rate is not applicable on sale of shares of private companies as shares of private companies are not covered in the definition of “securities” as per the Securities Contract Regulations Act (SCRA). The amendment clarifies that the benefit of 10% tax rate is available to private companies, provided they do not fall in the definition of a company “in which public are substantially interested”. With the amendment, the long term capital gains earned by FPIs from sale of unlisted securities will be subject to tax at 10% plus applicable surcharge and cess.

- Minimum Alternate Tax (MAT) not to apply to foreign companies (including FPIs) for the period beginning April 1, 2001:
 - In case of foreign companies resident in a country with which India has signed a tax treaty, MAT will not apply for prior periods if the foreign company does not have a PE in India
 - In case of foreign companies resident in a country with which India has not signed a tax treaty, MAT will not apply for prior periods if the foreign company is not required to seek registration in India under any law relating to companies

Impact– For period starting April 1, 2015, the Government had in the last Budget clarified that MAT will not apply to capital gains, interest income and royalties & fees for technical services earned by foreign companies. Since the amendment in the last budget was effective April 1, 2015, tax officers had sought to levy MAT on foreign companies (including FPIs) for earlier periods. The above amendment in the Budget seeks to put the MAT controversy to rest.

- Income distributed by Special Purpose Vehicles (SPVs) to Real

Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (INVTs) will be exempt from Dividend Distribution tax (DDT).

Impact – Dividends paid by SPVs will get complete pass through status.

- Timeline for payment of advance tax has been made consistent for both corporate and non-corporate taxpayers i.e. all taxpayers need to pay 15% tax on total income by June 15, 45% by September 15, 75% by December 15 and 100% by March 15 of the relevant financial year.

Impact – Currently, non-corporate taxpayers need to pay their taxes in advance in different instalments. The amendment seeks to bring consistency for both corporate as well as non-corporate taxpayers.

- Timeline for filing of belated tax returns reduced by 12 months.
Impact – Currently, taxpayers can file belated tax returns within 2 years from the end of the relevant financial year in which the income was earned. This timeline has been reduced to 1 year.

General Anti-Avoidance Rules (GAAR)

- The Finance Minister announced in his budget speech that Government is committed to implementation of General Anti-Avoidance Rules (GAAR) effective April 1, 2017.

Impact–The current Rules contain subjective tests around commercial substance, main purpose, misuse / abuse etc. As per the Finance Ministers Speech and Memorandum to the Finance Bill, 2015 investments made up to March 31, 2017 would be protected from the applicability of GAAR provisions

Tax reforms

- With the objective of reducing litigation at the first appellate authority level (Commissioner of Income Tax –Appeals), a Dispute Resolution Scheme has been introduced under which taxpayers can settle the dispute with the tax authorities resulting in withdrawal of appeals filed against scrutiny assessment (tax audit) orders or penalty orders. The scheme provides:



- If the disputed tax amount is upto INR 1 million, taxpayer can settle the dispute by paying tax amount and interest upto the date of assessment (tax audit) thereby waiving off penalty.
 - If the disputed tax amount is more than INR 1 million, taxpayer can settle the dispute by paying tax, interest and 25% of minimum penalty leviable.
 - Any pending appeal against a penalty order can also be settled by paying 25% of the minimum penalty leviable.
 - A one-time dispute resolution scheme has been introduced to settle any ongoing cases under any retrospective amendment in terms of which the taxpayer can pay the principal tax due. Interest and penalty will be waived in such cases.
 - Stay of demand
 - The Assessing officer is generally required to grant stay of demand, where the taxpayer has filed an appeal to Commissioner of Income Tax (appeals) and pays 15% of the demand.
 - Rationalizing of penalty provisions:
 - Penalty will be levied at 50% of tax in case of underreporting of income and 200% of tax where there is misreporting of facts.
 - The phrases “underreporting” and “misreporting” have been defined
 - Time limit of one year has been provided for disposing petitions of the tax payers seeking waiver of interest and penalty.
 - Change in timeline concerning scrutiny assessments (tax audits)
 - The timeline to complete scrutiny assessment (tax audit) is proposed to be reduced from 3 years to 33 months from the end of the relevant financial year.
 - The timeline to complete re-opened scrutiny assessments is proposed to be reduced from 1 year to 9 months from the end of financial year in which re-opening notice was issued.
 - Change in interest payable to taxpayer on refund of tax:
 - In case the annual tax return is filed after the due date, the interest on refund would start from the date of filing return and not from April 1 of the assessment year.
 - In case where a refund arises out of appeal effect being delayed beyond 90 days from the appellate order, the taxpayer will be entitled to additional interest of 3% per annum from the delay beyond the 90 days period to the date of refund.
 - Minimizing litigation
 - In order to minimise litigation, the government has proposed to do away with filing of appeal by the Assessing Officer against the order of the Dispute Resolution Panel.
 - Stable and predictable tax regime
 - Government has re-affirmed its commitment to not make any retrospective amendment in tax laws.
 - A High Level Committee to be constituted which would be chaired by Revenue Secretary and will consist of CBDT chairman and an expert from outside to oversee fresh cases where assessing officer applies retrospective amendment in relation to indirect transfer of shares.
- ### Policy Proposals
- Foreign investment upto 49 % will be allowed in the insurance and pension sectors in the automatic route subject to the extant guidelines.
 - 100% Foreign Direct Investment (FDI) in Asset Reconstruction Companies (ARCs) will be permitted under the automatic route. Also, FPIs will be allowed to invest upto 100% of each tranche in securities receipts issued by ARCs subject to sectoral caps.
 - Investment limit for foreign entities in Indian stock exchanges will be enhanced from 5% to 15%.
 - FPI investment limit in Central Public Sector Enterprises, other than Banks, listed in stock exchanges, will be increased from 24% to 49%.
 - The eligible FDI instruments will be expanded to include hybrid instruments subject to certain conditions.
 - FDI will be allowed beyond 18 specified NBFC activities under the automatic route in other activities which are regulated by financial sector regulators.

Annexure – FPI Tax rates (as proposed by Finance Bill, 2016)

Capital Gains

	Corporate Taxpayer			Non-Corporate Taxpayer	
	Total Income (upto Rs10 mn)	Total Income (Exceeding Rs10mn but up to Rs. 100 mn)	Total Income (Exceeding Rs. 100 mn)	Total Income (upto Rs. 10 mm)	Total Income (Exceeding Rs. 10 mm)
Transfer of equity shares, units of equity oriented fund chargeable to Securities Transaction Tax (STT)					
Short-term capital gains	15.45%	15.759%	16.2225%	15.45%	17.7675%
Long-term capital gains	Exempt	Exempt	Exempt	Exempt	Exempt
Transfer of securities not chargeable to STT					
Short-term capital gains	30.90%	31.518%	32.445%	30.90%	35.535%
Long-term capital gains	10.30%	10.506%	10.815%	10.30%	11.845%

Dividend / Interest Income

	Corporate Taxpayer			Non-Corporate Taxpayer	
	Total Income (upto Rs10 mn)	Total Income (Exceeding Rs10mn but up to Rs. 100 mn)	Total Income (Exceeding Rs. 100 mn)	Total Income (upto Rs. 10 mm)	Total Income (Exceeding Rs. 10 mm)
Dividend from Indian Companies	Exempt	Exempt	Exempt	Exempt	Exempt
Interest on Govt. bonds and certain corporate bonds upto June 30, 2017	5.15%	5.253%	5.4075	5.15%	5.9225%
Income from Securities (excluding above)	20.6%	21.012%	21.63%	20.6%	23.69%

1. The tax rates for Corporate taxpayer are inclusive of surcharge @ 2% (where income exceeds Rs. 10mn but does not exceed 100mn) or @5% (where income exceeds 100mn) and education cess @ 3%
2. The tax rates for Non-corporate tax payer are inclusive of surcharge @ 15% (where income exceeds Rs.10mn) and education cess @ 3%
3. Dividends/ income from units will be exempt provided the Indian company declaring the dividend pays dividend distribution tax (DDT) on the dividends declared
4. The interest rate on corporate bonds should be within 500 bps of the applicable base rate of State Bank of India



Securities Transaction tax (STT)

Taxable transaction	Rate	Payable by
Purchase and sale of equity shares on stock exchanges	0.1%	Purchaser / Seller
Sale of equity oriented mutual fund units on stock exchanges / sale of equity oriented mutual fund units to mutual fund	0.001%	Seller
Sale of options	0.05%	Seller
Exercise of options	0.125%	Purchaser
Sale of futures	0.01%	Seller
Sale of unlisted equity shares under an offer for sale to the public included in an initial public offer and such shares are subsequently listed on a stock exchange	0.2%	Seller

Note: Securities transaction tax is levied by the stock exchanges and is included in the settlement price of the transaction.

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