Deloitte.

India Budget 2022
Impact for Foreign Portfolio Investors

4 February 2022

Economic Indicators

Direct Tax

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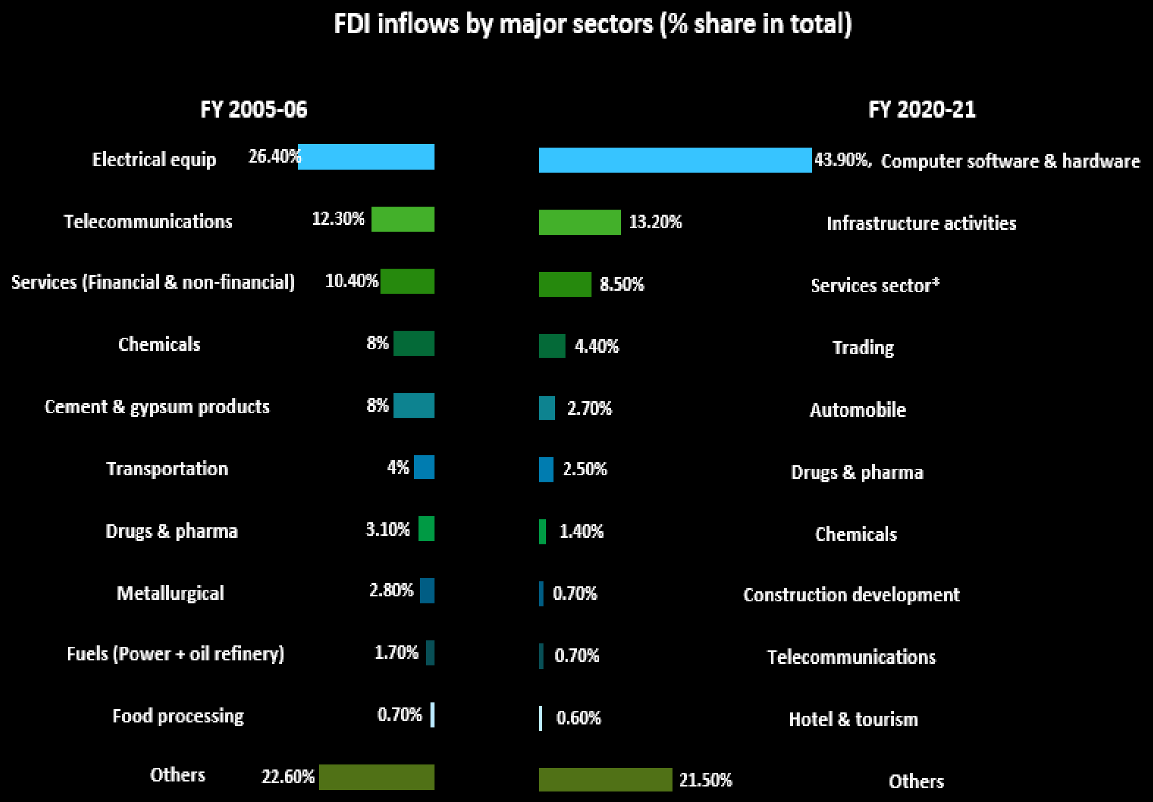
Economic Indicators

Capital market: the knight in the shining armour

Strong capital inflows have led capitalization to increase two times; FDI has been the dominant form

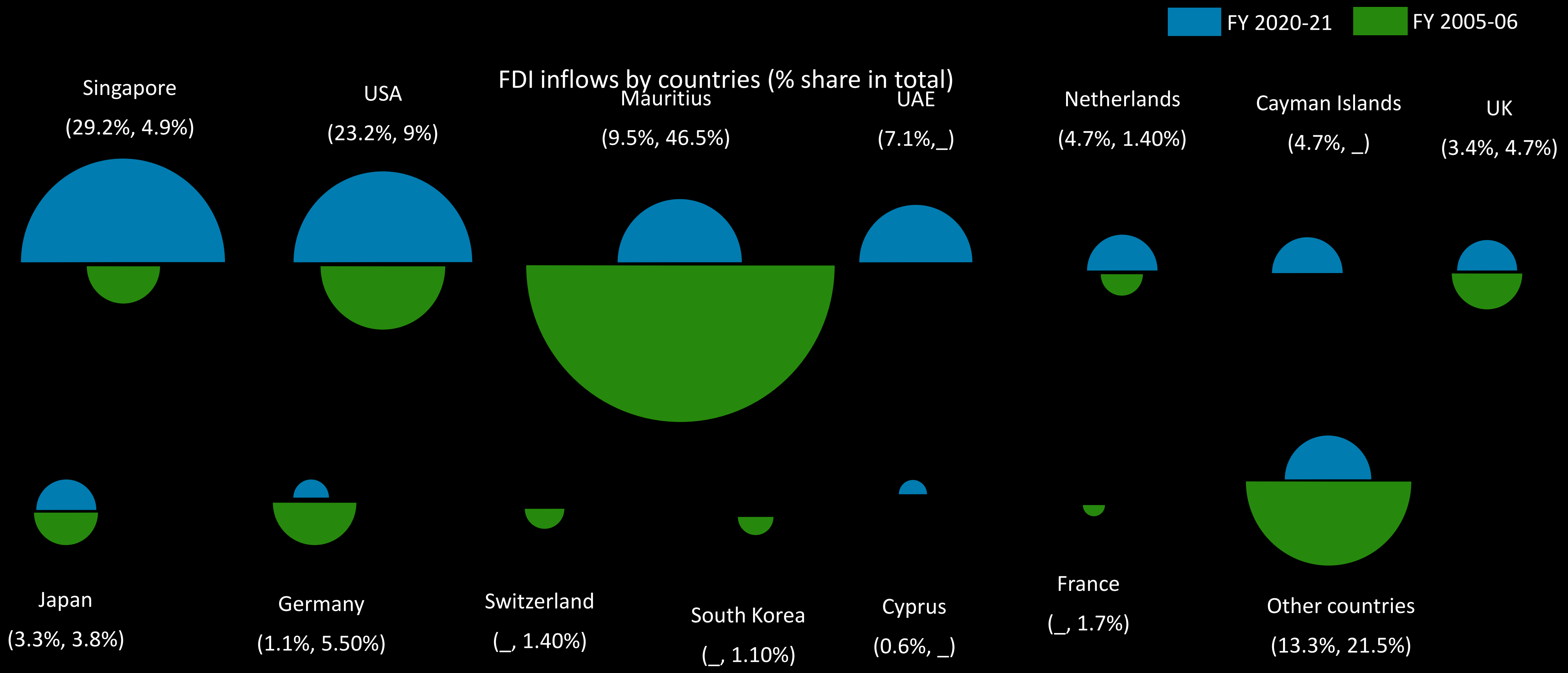
A majority has gone in the computer software and hardware sector and infrastructure; the manufacturing and telecom sectors have lost their share



Source: CMIE

Singapore and the US are the biggest investors in India

Investment from Mauritius has declined and so has the share of the European countries



Source: CMIE

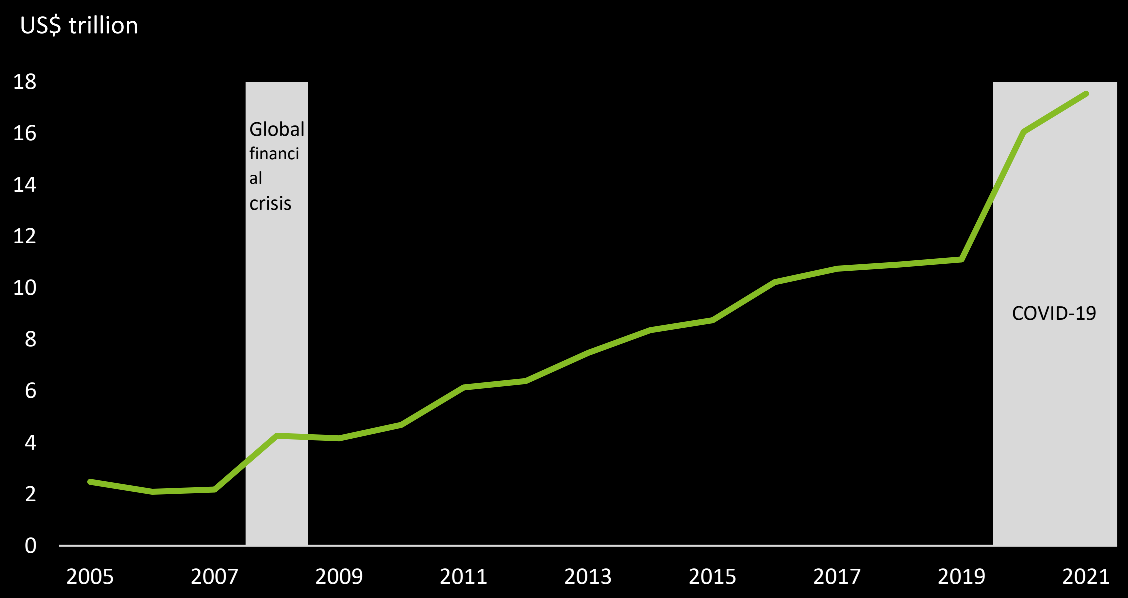
Could a decline in global liquidity pose a risk?

Total liabilities of central banks in the United States, European Union, and Japan have increased eight times since the global financial crisis and prices are rising (transitory)

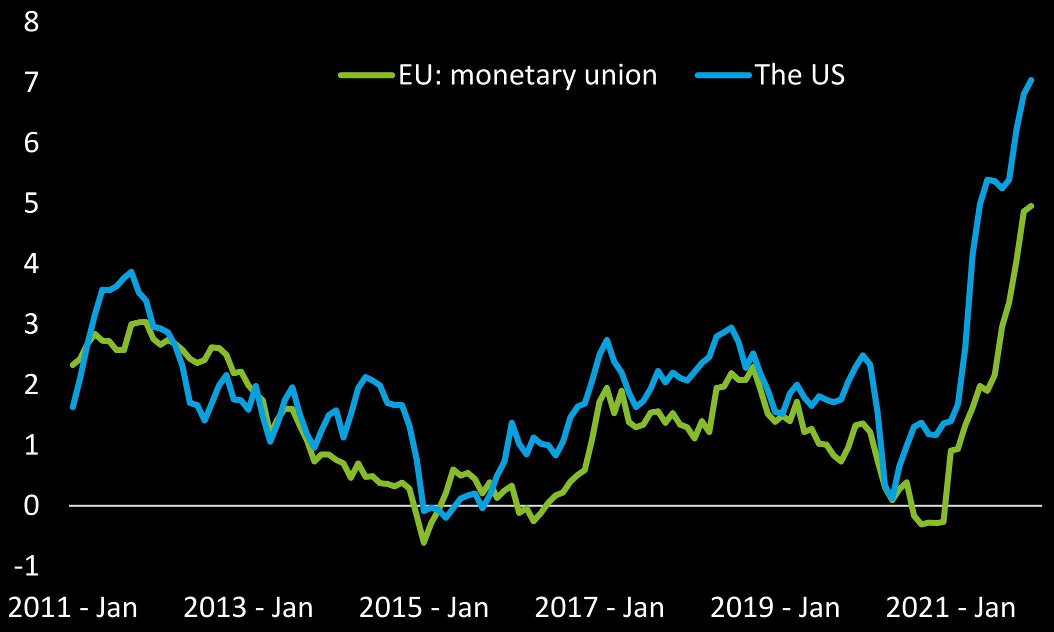
The US Fed decides to taper purchases and the EU is hinting at raising policy rates

Can the country endure taper tantrum 2.0?

Total liabilities of central banks of the US, EU, and Japan



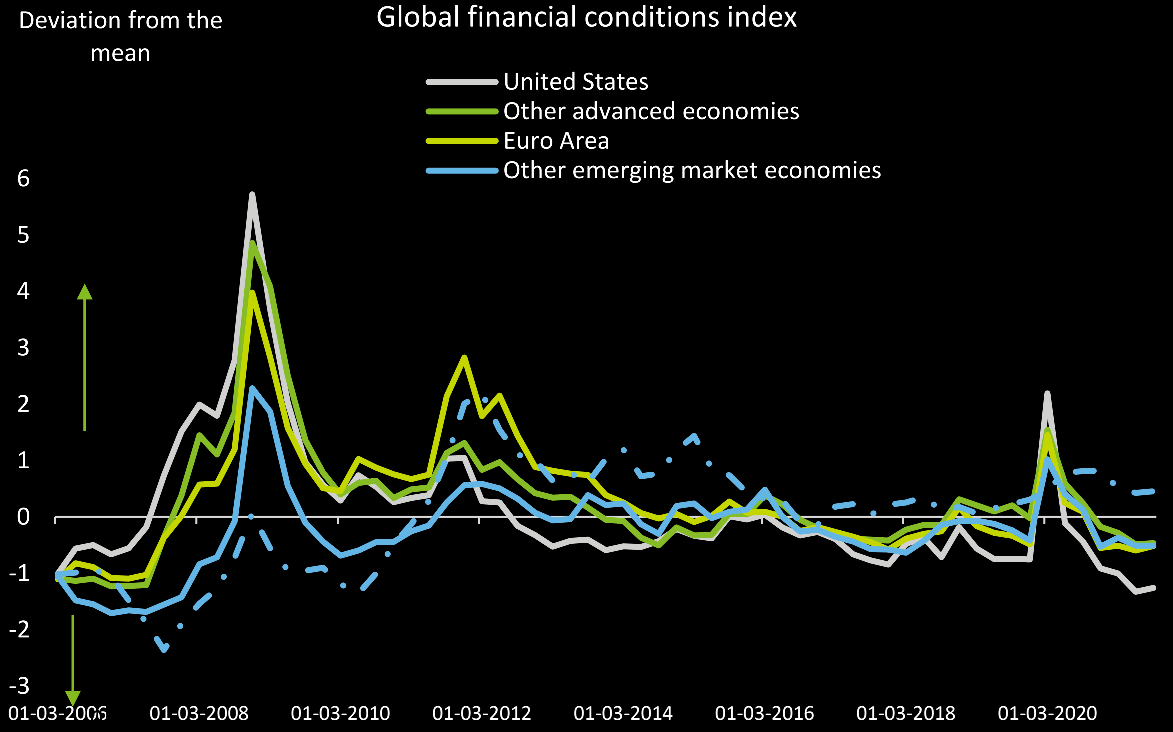
CPI inflation in industrial economies

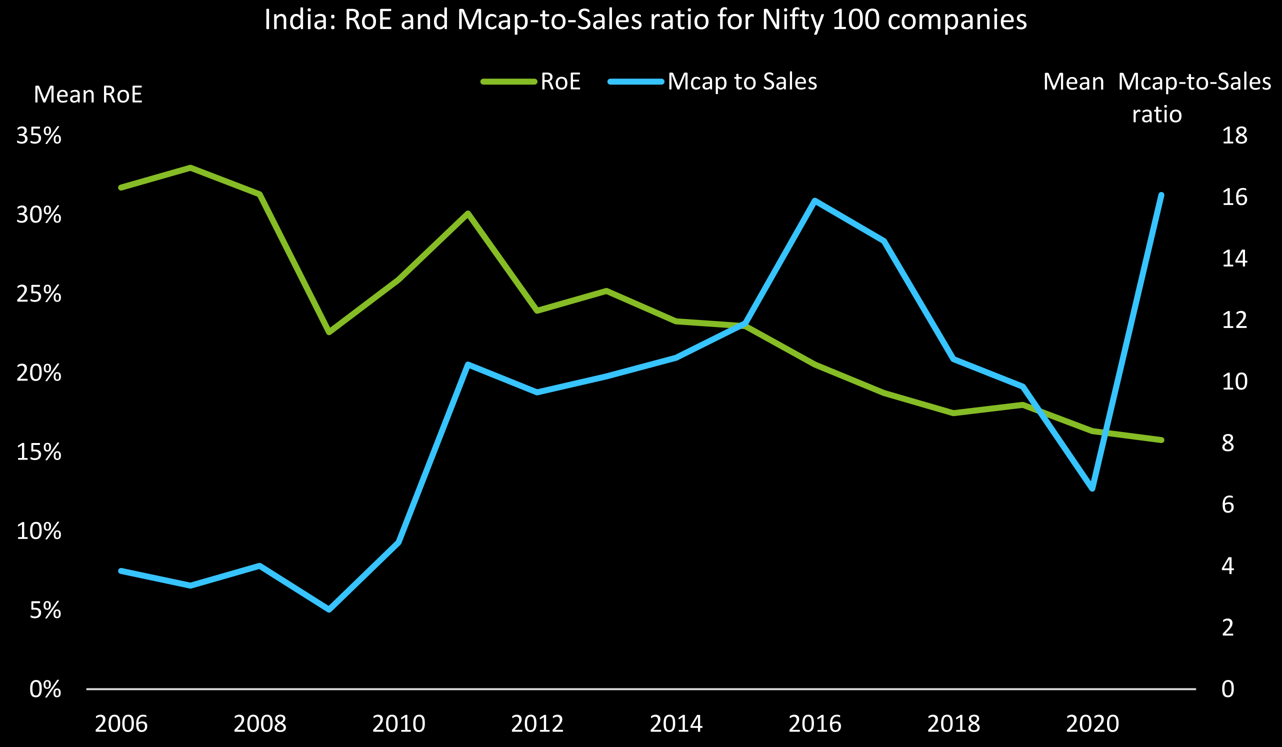


Source: Haver analytics L.P.

Despite the tightening of the monetary policies, the financial conditions have eased, except in China

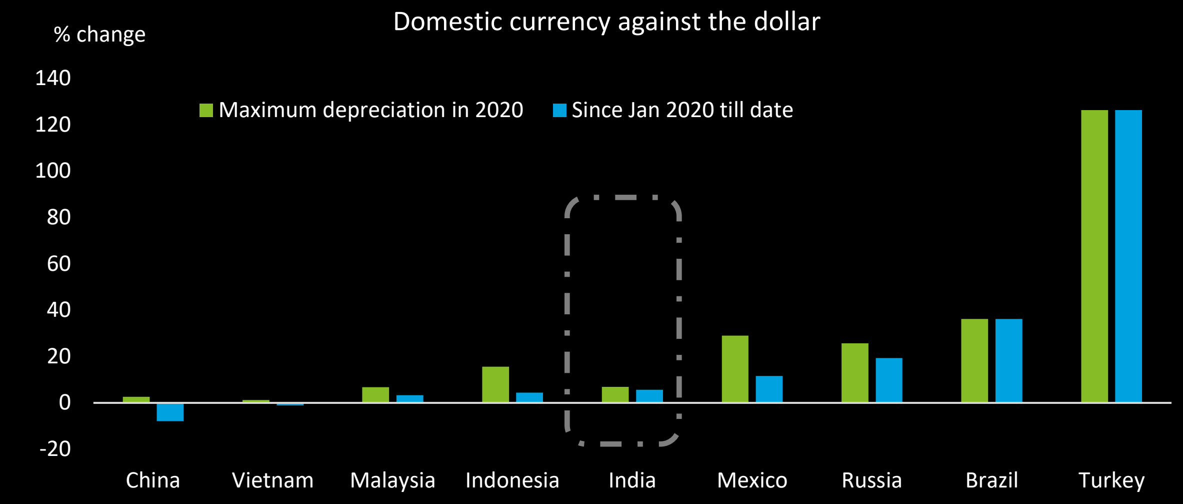
There is a stretch in valuations in few segments of the financial markets, such as corporate valuations and exposure to external costs

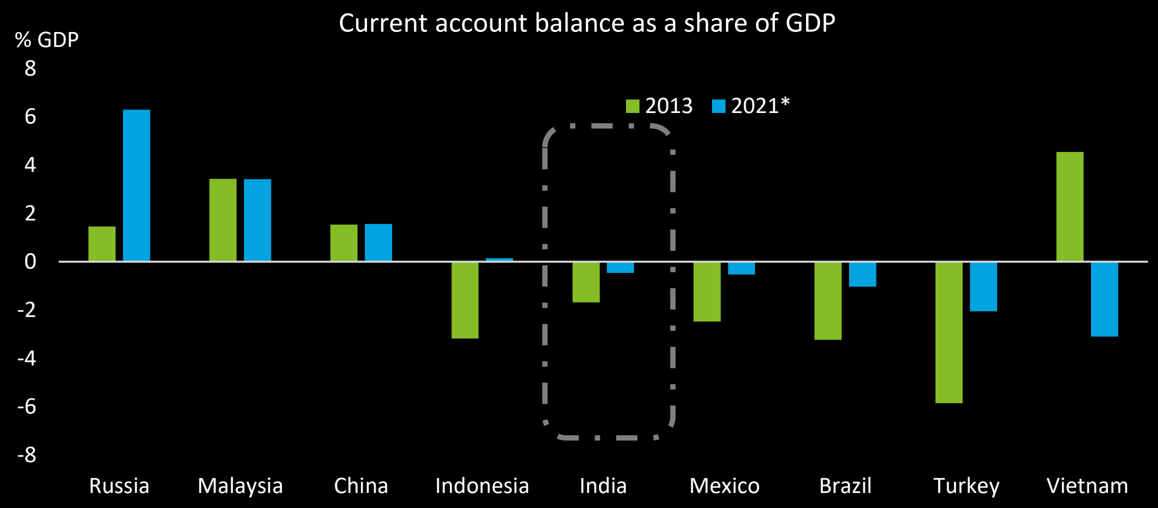




India's fundamentals are now relatively strong and it is better placed to handle outflows

Stock market has outperformed due to strong FDI flows, currency, and improved external account

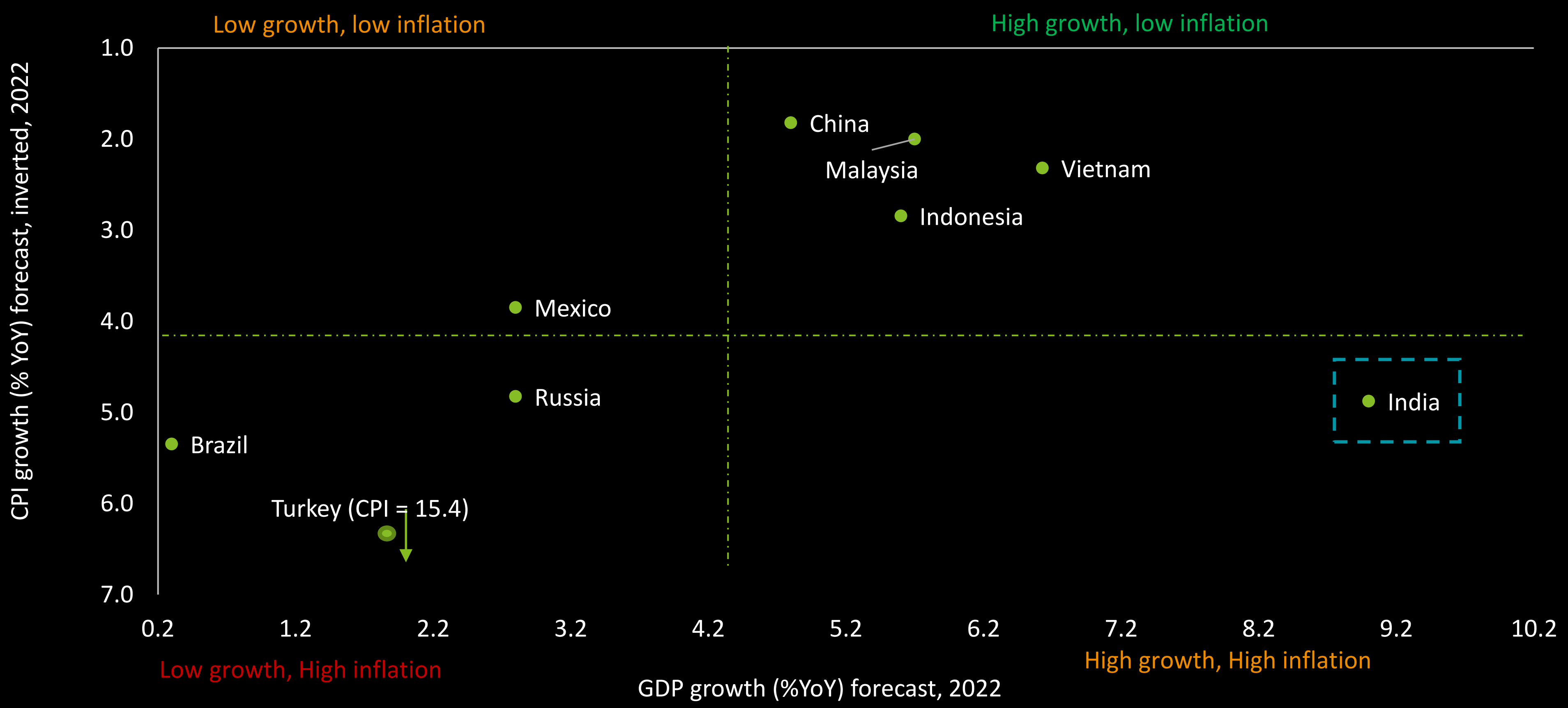




Note: 2021 numbers are estimated using monthly/ quarterly numbers
Source: Haver analytics L.P.

India remains a prospective investment destination because of growth prospects

Inflation is a concern (third highest) and might be a worry for the RBI as global liquidity falls



Source: IMF predictions sourced from Haver analytics L.P.

Sector analysis and the possible budget impact

Economy is projected to grow by 9.2 percent in FY22, but output will likely remain much below potential levels (no-COVID levels)

Covid mutations, rising inflation, and weak demand pose significant downside risks

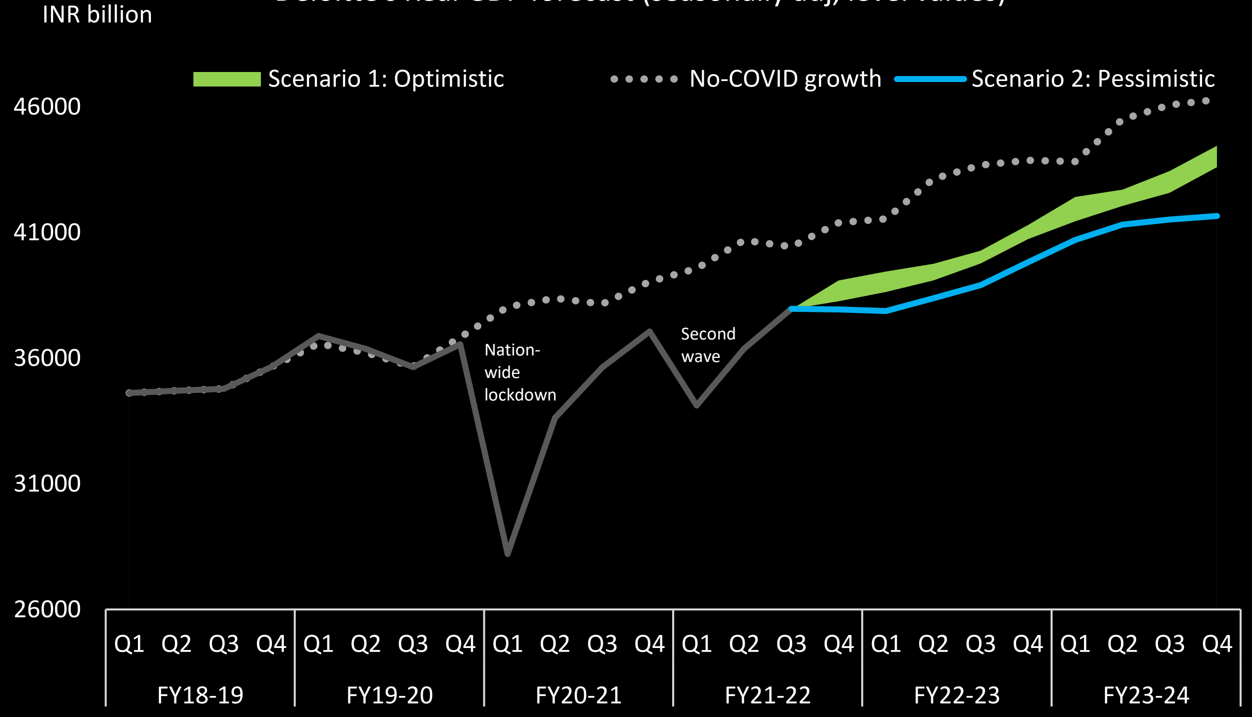
Drivers

- Vaccine coverage and reduced mobility restrictions
- Gains from supply-side reforms
- Easing of regulations
- Robust export growth
- Availability of fiscal space to ramp up capital spending.

Risks

- Possible infection surge
- Inflation
- Fiscal deficit
- Credit growth
- Job growth

Deloitte's Real GDP forecast (seasonally adj, level values)



Note: Projections don't account for the latest GDP revision of the past year

Sector-wise announcements: A blueprint from India @75 to India @100

FSI

Ease of doing business:

- International arbitration centre at GIFT City
- IBC reforms to enhance the efficacy of the resolution process

Inclusion and better penetration and efficiency in transactions

- Core banking solutions to be offered by India Post
- RBI to launch digital rupee using blockchain in FY23
- Tax on crypto investments

TMT

Bridging the digital divide

- Bharat Net Optical fiber project to bring broadband across villages & remote areas

Building the new-age digital infrastructure

- Spectrum auctions of 5G airwaves will be conducted this year to roll out 5G services in 2022-23
- Design led manufacturing to be launched for 5G ecosystem

G&PS

Focusing on building productive capacity and last mile efficiencies

- Expand the capex target by 35.4 percent from INR 5.54 trillion to INR 7.50 trillion. For FY23, effective capex will be INR 10.7 trillion

Boosting infrastructure spending with multiplier effect on jobs and income

- 100 new cargo terminals to be developed in three years
- Four multi-modal logistics parks to be developed in FY23

Sector-wise announcements: A blueprint from India @75 to India @100

Healthcare

Focus on social infrastructure and quality of living

- Focus on child health through 200,000 Anganwadi upgradation
- National Digital Health Ecosystem to be rolled out under Ayushman Bharat Digital Mission (ABDM)
- National Tele Mental Health program for quality mental health counselling and care services

ER&I

Sustainability and climate change

- Four pilot projects for coal gasification and conversion into industrial chemicals
- Focus on manufacture of high efficiency solar modules under PLI

Boost to the chemical industry and local defense industry

- The 68% of the defence capital to be used for domestic procurement
- Reduced customs duty on certain critical chemicals

Consumer

Support to pandemic-impacted sectors and promotion to green mobility

- Hospitality sector to avail benefit of extension of ECLGS till FY23
- Enhancing the EV ecosystem

Tax Proposals

Introduction of bonus stripping provisions to shares and other specified securities

Bonus stripping now applicable to shares, REITs, InvITs and AIFs

- Current Provision: Bonus stripping provisions apply only to units of Indian mutual funds.

- Proposal: It is proposed to introduce bonus stripping provisions in the tax law to cover stocks and shares, units of Real Estate Investment Trust (REIT), Infrastructure Investment Trust (INVIT) and Alternate Investment Funds (AIF) (collectively referred to as securities). This provision would apply if the following conditions are met:

  - If a person buys securities within 3 months prior to the record date
  - Such person is allotted additional (e.g. bonus) securities on the basis of securities held on the record date
  - The original securities (held on the record date) are sold within 9 months after the record date while continuing to hold all or any of the additional securities

- Impact: Any loss suffered by a taxpayer in the above situation on sale of original securities within 9 months after the record date would be disallowed. Further, such disallowed loss would be deemed to be the cost of acquisition of the additional (e.g. bonus) securities. Arguably, the provision should not apply if all securities including the bonus securities are sold.

Illustration

- Investor purchases 100 shares of X Ltd on 1 April 2022 at a cost of INR 1000/share.
- X Ltd announces bonus shares in the ratio of 1:1 and fixes the record date as 15 April 2022.
- Investor receives 100 bonus shares on original holding of 100 shares.
- On 1 May 2022, ABC sells the original shares at a sale price of INR 600/share and incurs a total short term capital loss of INR 40,000 (400/share).

Treatment under current provisions	Treatment under proposed provisions
• The short-term capital loss of INR 40,000 can be offset against any other capital gain • The cost of 100 bonus shares will be 'zero'	• The short-term capital loss of INR 40,000 will not be allowed to set-off against other capital gains • The cost of 100 bonus shares will be INR 40,000 i.e. INR 100/share.

Note: Different views are possible on allocation of cost to bonus shares in a situation, where the taxpayer sells the whole / part of bonus shares along with original shares (whether proportionate theory can be applied).

Proposals to incentivize investment activity in IFSC

Income of non-residents from offshore derivative instruments (ODI) and over-the-counter (OTC) derivatives

Current Provision: Income received by a non-resident from transfer of non-deliverable forward contracts entered into with Offshore Banking Units (OBUs) in International Financial Services Center (IFSC) is exempt from tax.

Proposal

- It is proposed to extend this exemption to income from ODIs (such as Participatory Notes or Total Return Swaps) and other OTC derivatives entered into by non-resident with OBUs in IFSC.

Comments

- This proposal provides certainty to non-residents that any gains arising from bilateral derivative contracts entered into with OBUs in IFSC will not be exposed to Indian tax. Further, it also provides clarity to OBUs that there should be no tax withholding when payments are made to non-residents upon settlement of such contracts.
- The exemption covers contracts entered by non-residents only with OBUs. Accordingly, any derivative contracts entered by non-residents with other entities in IFSC such as AIFs, Portfolio Managers etc., would not qualify for tax exemption.

Income of non-residents from offshore investments managed by Portfolio Manager in IFSC

Proposal:

- Income of non-residents from portfolio of offshore securities, financial products or funds managed by a Portfolio Manager in IFSC is proposed to be exempt from tax provided the conditions mentioned below are met:
    - Such income should not be deemed to accrue or arise in India.
    - Such income is credited to a bank account maintained with an OBU in IFSC

Comments

- Where the non-resident also invests in onshore (mainland India) securities, income earned from such onshore securities will not be covered in the proposed exemption.
- This proposal would provide certainty to non-resident investors that income earned by them from offshore securities would not be taxed in India. Currently, there is a possibility that such income may be taxed in India on the basis that such income arises from investments managed by a Portfolio Manger located in IFSC.

Proposals to incentivize investment activities in IFSC (contd…)

Other amendments

- Current provision: Amount received by the Indian company on issue of shares exceeding the FMV is taxable in the hands of the Company, except in case shares are issued to a "Specified Fund".

  Proposal: The definition of Specified Fund is expanded to include Category I and II AIFs regulated under the IFSCA Act, 2019.

- Current provision: Royalty and interest received by a non-resident on lease of an aircraft paid by a unit in IFSC is exempt from tax, if such IFSC unit has commenced its operations on or before 31 March 2024.

  Proposal: The above exemption is proposed to be extended to royalty and interest income on lease of a "Ship".

Other proposals to promote IFSC

- Setting-up of International Arbitration Centre for timely settlement of disputes under international jurisprudence.

- Allowing foreign universities and institutions to offer various courses free from domestic regulations, with certain exceptions.

- Facilitate services for global capital for sustainable & climate finance in the country.

Promoting voluntary tax compliance, reducing litigation and deterring tax evasion

Filing 'Updated tax return' up to 3 years after the end of relevant fiscal year

- Proposal: To correct any errors / omissions in estimating the total income, it has been proposed to allow taxpayers to file an 'updated' tax return subject to payment of additional tax.

  Due date: 3 years from the end of the fiscal year (irrespective of whether the original / revised / belated return has been filed or not).

- Additional tax to be paid at the rate of 25 percent of the tax and interest payable on the additional income disclosed in the updated return if such return is filed within 24 months from the end of the fiscal year. The tax rate will be 50 percent if updated return is filed between 24 to 36 months.

- Time limit for initiating tax audits in such cases is 9 months from the end of fiscal year in which the updated return is filed.

- Exceptions: Updated return cannot be filed if:
  - It results in a loss / decrease in total tax liability / refund / increase of refund due
  - Any tax audit proceedings are pending or have been initiated
  - An updated return has already been filed

Litigation management to avoid repetitive appeals by the Department

- Proposal: In a scenario where a favorable order is received by a taxpayer, the Income Tax Department may wish to appeal further to higher appellate authorities. However, if another matter (in the case of the same taxpayer or any other taxpayer) is pending before a jurisdictional High Court or the Supreme Court of India which involves an identical question of law, it is proposed that the tax authorities could defer the filing of further appeal till the existing question of law has been decided by relevant High Court or Supreme Court. However, this will be subject to acceptance by the taxpayer.

No set-off of losses against undisclosed income

- Proposal: It has been proposed to disallow set-off of losses, brought forward or otherwise against undisclosed income detected during search and survey operations.

Other amendments

No changes proposed to tax rates

Surcharge on long term capital gains restricted to 15% for all taxpayers

- Current Provision: For taxpayers other than FPIs, corporates and partnership firms, the surcharge on long term capital gain from sale of securities (other than listed shares/units of business trust, equity oriented mutual funds) can go upto 37 per cent on a graded basis.

  Proposal: It is proposed to cap surcharge to 15 percent for long term capital gains on sale of all long-term capital assets including unlisted shares, bonds and other unlisted assets.

Surcharge on AOPs restricted to 15 percent if all members are companies

- Current Provision: For Association of Persons (AOPs), the surcharge rate on tax on certain income can go up to 37 per cent.

  Proposal: It is proposed to cap such the surcharge to 15 percent where all the members of the AOP are companies.

Taxation of virtual digital assets

- Any income from transfer of virtual digital assets (e.g. cryptocurrencies, non-fungible tokens) will be taxable at 30 percent (plus applicable surcharge and cess). No deduction (other than cost of acquisition) and no off-setting of any other losses would be allowed in calculating the net income from transfer of digital assets. A gift of a virtual digital asset is also to be taxed for the recipient. Further, the payer of income would need to withhold tax @ 1 percent while making a payment on transfer of virtual digital asset to an Indian resident.

Dividend stripping applicable to units of REITs, InvITs and AIFs

- Currently, the dividend stripping provisions apply only to dividends received on units of Mutual Funds. It is proposed to extend these provisions to dividends received from REITs, InvITs and AIFs as well. Accordingly, if a person acquires units of REITs / InvITs and AIFs within three months prior to record date of dividend, receives dividend which is exempt from tax and transfers such unit within nine months after the record date, any loss suffered from such transfer will be ignored for the purpose of computing taxable income to the extent of such tax-exempt dividend income received or receivable on such units.

Key FPI tax issues represented to Government which are yet to be addressed

- **Availability of tax rate of 5 percent on interest arising to FPIs from units of business trusts:** Representations were made to the government for providing a carve out to restrict the tax rate on such interest received and withholding thereon to 5 percent. Also, units of business trusts should be specifically included in the definition of a short-term capital asset such that they can also be classified as long-term capital assets if held for 12 months and short term is otherwise.

- **Need for common treatment of investment funds:** The government could consider classifying all investment funds as companies for the purpose of taxation in line with the practice already followed in certain countries such as US and UK.

- **Re-structuring of funds outside India:** Restructuring of funds outside India should not be regarded as a taxable transfer under capital gains provisions subject to satisfaction of certain conditions.

- **Long term grandfathering benefits to shares received through corporate actions on shares held as on 31 January 2018:** The government could consider issuing a clarification that shares received through corporate actions from 1 February 2018 onwards would also qualify for grandfathering benefits provided in section 55(2)(ac) of the Income Tax Act, 1961 (Act) provided the original shares on which such resultant shares are received were acquired prior to 1 February 2018.

- **Exemption on government bonds traded outside India:** The government could consider to provide a full tax exemption on government bonds traded outside India under the Fully Accessible Route.

- **Set-off of all capital losses (particularly long-term capital loss against short term capital gain):** The government could consider to allow the set off of long-term losses against short term gains in order to simplify the capital gains computation and to allow the taxpayers to reduce their overall tax burden.

- **Cost of shares to be averaged out between original and bonus shares:** The government could consider amending the current tax law to provide that upon receipt of bonus shares the cost of original shares should be averaged out between the original shares and the bonus shares.

- **Distribution tax on buyback of shares:** In line with abolition of dividend distribution tax, the government should consider doing away with distribution tax on buybacks and the income should be taxable in the hands of shareholders as capital gains tax.

Annexures

FPI Tax Rates

Type of Income		Corporates			Partnership Firms	
		Income ≤ INR 10 mn	Income > INR 10 mn ≤ INR 100 mn	Income > INR 100 mn	Income ≤ INR 10 mn	Income > INR 10 mn
Capital gains on transfer of listed equity shares/equity oriented mutual fund /units of business trust (subject to STT)	Long-term*	10.4	10.608	10.92	10.4	11.648
	Short-term	15.6	15.912	16.38	15.6	17.472
Capital gains on transfer of other securities (including derivatives and debt Mutual Funds)	Long-term	10.4	10.608	10.92	10.4	11.648
	Short-term	31.2	31.824	32.76	31.2	34.944
Interest income on government securities, qualifying corporate bonds and municipal bonds**		5.2	5.304	5.46	5.2	5.824
Dividend and other income from securities		20.8	21.216	21.84	20.8	23.296
Interest on Income Tax Refunds		41.6	42.432	43.68	31.2	34.944
Buyback of shares##		Exempt	Exempt	Exempt	Exempt	Exempt

*grandfathering benefits shall be available incase the securities are purchased before 1 February 2018.

** 5% (plus surcharge and cess) is applicable on interest on government bonds and those corporate bonds whose coupon rate does not exceed 500 bps of base rate of State bank of India on date of issuance of bonds.

##The Indian company paying buyback proceeds is required to pay distribution tax.

FPI Tax Rates

Type of Income		Non-Corporates (including Trusts, Association of Persons, Individuals, Artificial Juridical Persons)				
		Income ≤ INR 5 mn	Income > INR 5 mn ≤ INR 10 mn	Income > INR 10 mn ≤ INR 20 mn	Income > INR 20 mn ≤ INR 50 mn	Income > INR 50 mn
Capital gains on transfer of listed equity shares/equity oriented mutual fund /units of business trust (subject to STT)	Long-term*	10.4	11.44	11.96	11.96	11.96
	Short-term	15.6	17.16	17.94	17.94	17.94
Capital gains on transfer of other securities (including derivatives and debt Mutual Funds)	Long-term	10.4	11.44	11.96	11.96	11.96
	Short-term	31.2	34.32	35.88	35.88	35.88
Interest income on government securities, qualifying corporate bonds and municipal bonds**		5.2	5.72	5.98	6.5	7.124
Dividend and other income from securities		20.8	22.88	23.92	23.92	23.92
Interest on Income Tax Refunds		31.2	34.32	35.88	39	42.744
Buyback of shares##		Exempt	Exempt	Exempt	Exempt	Exempt

*grandfathering benefits shall be available incase the securities are purchased before 1 February 2018.

** 5% (plus surcharge and cess) is applicable on interest on government bonds and those corporate bonds whose coupon rate does not exceed 500 bps of base rate of State bank of India on date of issuance of bonds.

##The Indian company paying buyback proceeds is required to pay distribution tax.

India’s economic trajectory: A tale of two scenarios

We created two scenarios to discuss the economic trajectory India might take in the coming years

1. The first scenario is an optimistic one, of which we see a higher probability.

- *We expect pent-up demand to pick up at a rapid pace in the next few quarters* as the number of infections drops and more people get vaccinated. Higher demand results in a stronger capital-spending cycle with larger asset creation.
- Besides, the impact of higher spending on infrastructure, government schemes (such as production-linked incentives and self-reliance), and digitalization will start kicking in from 2023, leading to stronger externalities, higher productivity, and greater efficiencies—all leading to accelerated economic growth.
- High demand and supply, along with strong exports, will give the government the space to gradually consolidate its position over the next few years.
- Asset monetization and stronger capital inflows will further aid the government in reducing its expenses and improving the fiscal deficit.
- The current account deteriorates due to higher demand for imports, but strong exports keep a check on the deficit.
- Lower oil prices globally keep the oil import bill under control.

2. In our second scenario, a more pessimistic one, we see downside risks, such as rapidly mutating virus and reduced effectiveness of vaccination leading to intermittent local lockdowns.

- Furthermore, muted demand, supply chain inefficiencies, and poor business confidence will cause sporadic and unsustainable growth spurts over the next two years.
- Despite the low economic activity, we expect inflation to remain in the upper range of the RBI’s inflation target range (because of supply disruptions and lockdowns). This could result in stagflation in the years ahead.
- Low demand for oil and falling oil prices globally aid in improving the current account balance.

Thank you!

Kindly spare a minute to help us with your feedback for today's session…

For any queries, please feel free to write to us at intax@deloitte.com