

Union Budget: Make India a bright spot of Global Economy

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It is now well known that the Indian economy has resisted the global economic slowdown and instead offers a growth promise. Given the global situation viz. sluggish US economy with tight monetary policy, Russia-Ukraine war, and supply chain constraints in China, it is imperative that the policies formed by the Indian Government are consistent in order to ensure that India is a competitive and investor friendly destination for the global investment community. The Union Budget 2023 could play an important role in capitalizing on the promise and welcoming the flow of foreign investments into India.

Along with creating a conducive business environment, tax reforms play a vital role in uplifting the investor's sentiment that boosts foreign investment in India. Some of the possible areas in which rationalization can be achieved by the Union Budget 2023 to enhance foreign investor's confidence include:

- **Rationalisation of Corporate Tax Rate** - To provide impetus to the manufacturing sector, a lower corporate tax rate of 15% was introduced. This lower corporate tax rate is available for manufacturing companies which commence their operations before 31 March 2024. The said deadline to commence the operations could be extended till 31 March 2025. Also, this lower corporate-tax rate of 15% could be extended to services or product development companies with definitive capital requirement and investment conditions.
- **Simplification of Capital Gain tax regime** - The capital gains taxation for foreign investors is complex as it differs based on the investment viz. nature of asset, period of holding and rates of tax. Rationalizing these attributes to arrive at a simple capital gains tax mechanism would provide the required clarity to foreign investors on their investments in India.
- **Incentivising Research** - Through a deviation from the larger policy of the Government to

discontinue profit linked or investment linked incentives to corporates, introducing research-linked benefits to certain preferred sectors could generate multiplier effect on investments and also allow the Government to divert funds from the investors to specific focus areas. In addition, this could also generate large scale employment.

- **Lower Tax on Foreign Institutional Investors income from Business Trusts** - Due to a change in the definition of “securities” in The Securities Contract (Regulation) Act 1956 (‘SCRA’), there is an ambiguity on the applicable tax rate for Foreign Institutional Investors (‘FII’) holding units of business trusts, both Real Estate Investment Trust (‘REITs’) or Infrastructure Investment Trusts (‘InvITs’). SCRA has covered units of business trust as part of the securities definition for the purpose of levying stamp duty. As per section 115A of the Income-tax Act, 1961 (‘IT Act’), unit-holders of infrastructure bonds are taxable at the concessional rate of 5%. However, section 115AD of the IT Act taxes the income from securities in general at the rate of 20% and has reference to “securities” definition given under SCRA. Due to this reference, there is a possibility of taxing FIIs holding units of business trusts at a higher rate of 20%. The Government can iron out this unintended tax burden on FIIs by providing necessary relief from the higher tax rate.
- **Lower Withholding Tax on Rupee Denominated Bonds by Business Trusts**- The Reserve Bank of India allows Indian business trusts to issue Rupee Denominated Bonds (‘RDB’) to foreign institutional investors. As per section 194LD of IT Act, RDBs issued by Indian companies to FIIs are eligible for the concessional withholding tax rate of 5%. It may be clarified that similar tax rate can be applied to RDBs issued by business trusts to boost foreign investments in these trusts.

Along with the concessional tax rate for interest income, exemption of capital gains for foreign investors arising from the transfer of RDBs issued by Indian companies can be extended to RDBs issued by business trusts.

- **Applicability of section 194R of the IT Act to non-residents** - Withholding tax is introduced on benefit or perquisite provided to a resident. The provisions require even a non-resident to comply with the requirement of withholding of tax when any benefit or perquisite is provided to the resident. Supposing a foreign company is providing free samples to its subsidiary or any other Indian company then making the foreign company liable to withhold tax on such free samples would cause undue compliance burden on the foreign company. The Government can clarify to remove such hardship on foreign companies.
- **Review of Safe Harbour regulations** - Acknowledging the global economic slowdown by reviewing the safe harbour margins from the transfer pricing standpoint enhances the confidence of foreign investors and minimizes unforeseen tax litigation.
- **Requirement to obtain PAN for Form 10F submission** - Clarification on obtaining PAN in India by non-residents to file Form 10F to access the beneficial provisions under Double Tax Avoidance Agreement (‘DTAA’). Considering the potential hardship caused due to the requirement of obtaining PAN for Form 10F compliance, the Central Board of Direct Taxes has clarified that PAN is not required for compliances up to 31 March 2023. To completely settle the requirement of PAN for non-residents who are not required to file their tax return in India, alternative measures of facilitating acceptance of Form 10F with the use of tax identification number of the non-resident or non-PAN login facility can be considered.
- **Rationalisation of taxation of VDAs** - Taxation of cryptocurrency under the broader bucket of Virtual Digital Assets (‘VDA’) was introduced in last year’s budget. Income on the transfer of VDA is taxable at a flat rate of 30% plus applicable surcharge and cess. There is no progressive tax structure to tax long-term and short-term gains from VDA. This tax rate is the highest compared to various other economies viz Brazil, Canada, Japan, Switzerland, US, UK. Additionally, withholding of tax at the rate of 1% and non-availability of set-off of losses puts India in competitively disadvantageous position on taxation of VDA’s. Recent statistics show that transaction worth USD 3,055 million (~INR 253 billion) were lost by Indian VDA exchanges to offshore VDA exchanges in the 6 months from April to October 2022. The Government can re-look at the VDA tax regime to make India a competitive and preferred destination to trade in digital currency.

These tax measures coupled with the available skillset, infrastructure, market size and cost-efficient supply chain will support the Indian economy to continue to be a bright spot for attracting foreign investment despite the global economic slowdown.