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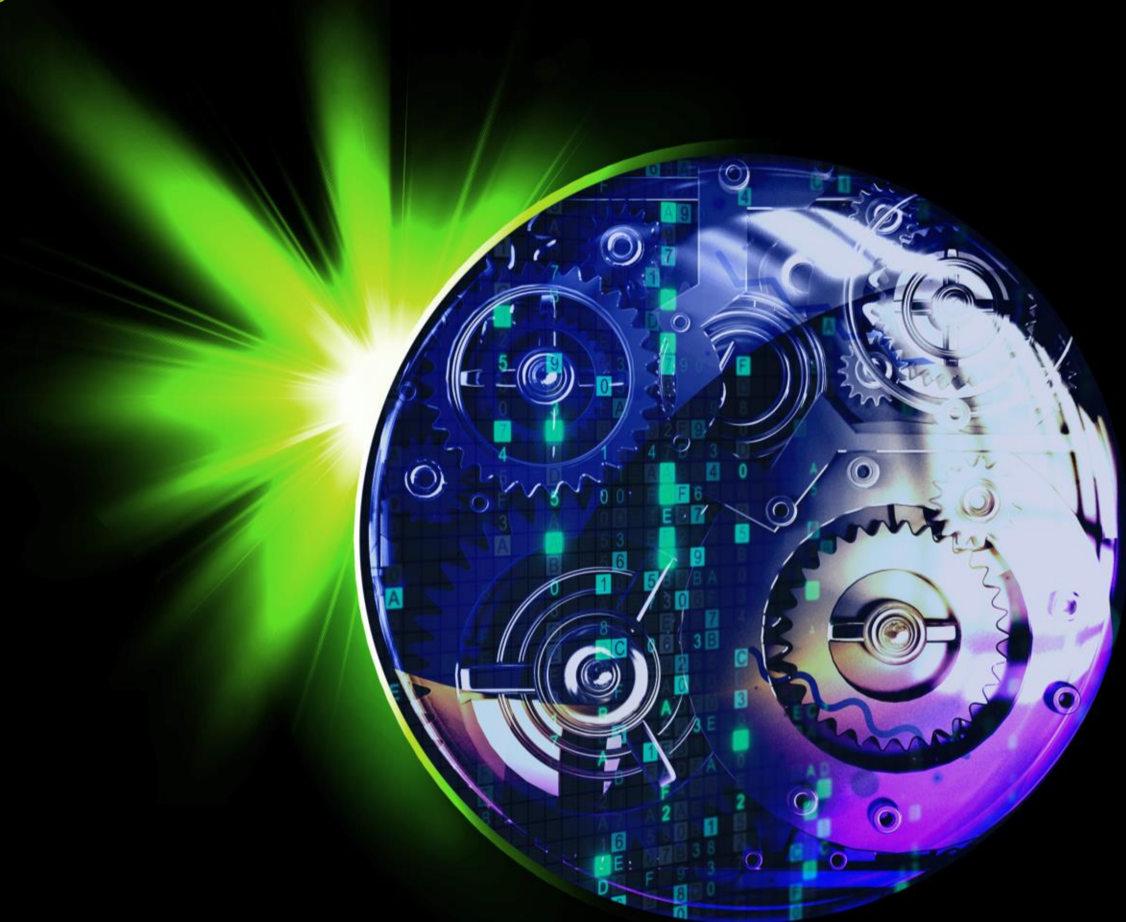


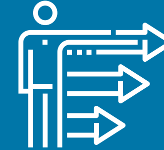
India Budget 2021 – FPI update

February 2021

State of Indian Economy

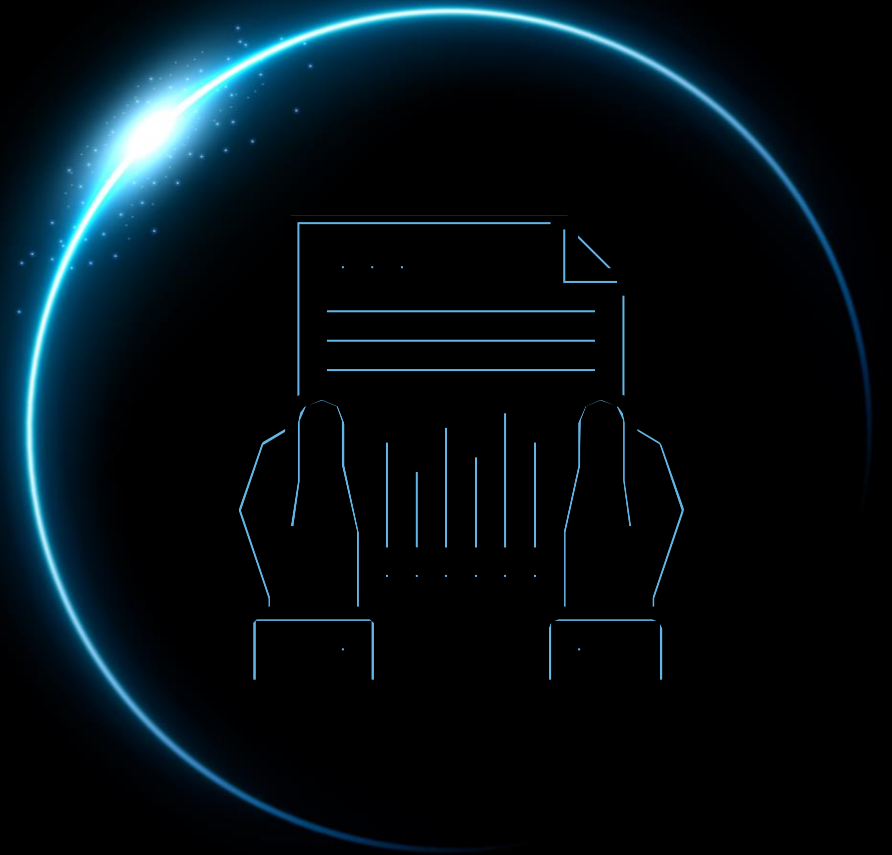
Budget 2020-21 theme

Direct Tax Proposals



Annexures

State of Indian Economy



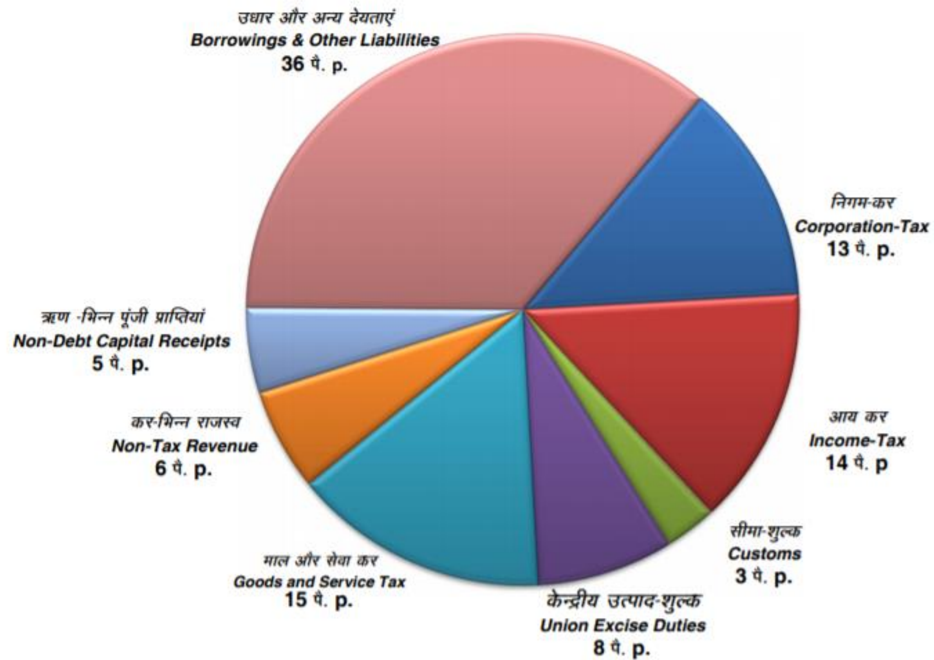
Economic Survey Pointers

How to attain a high, sustainable and inclusive growth?

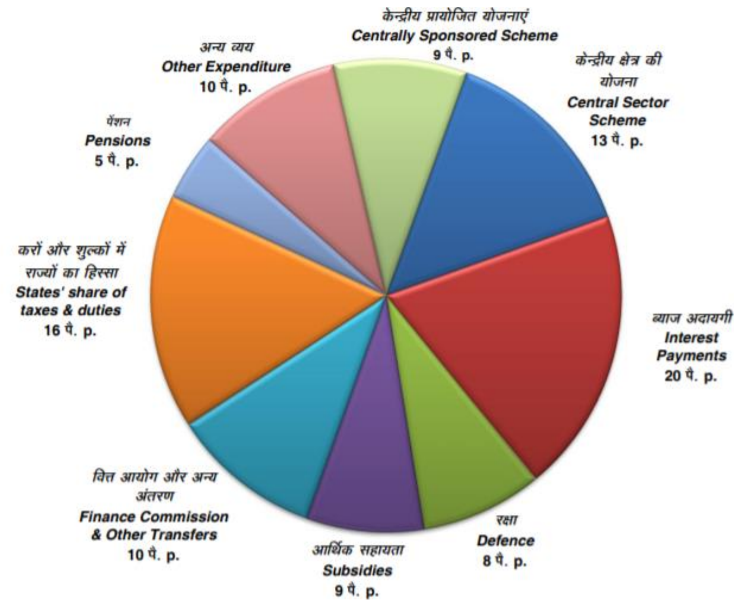
- Economic survey brings up the questions whether growth leads to debt sustainability in the Indian context?
- Sovereign credit rating of India is not appropriate. It does not reflect the economic fundamentals.
- Health care is an area of attention as India needs to build resilience and prepare itself better for future uncertainties.
- Addressing inequality is important for economic and social stability. Growth definitely plays an important role.
- Improving on innovation and move to higher spending on R&D

Budget and Fiscal

Revenue

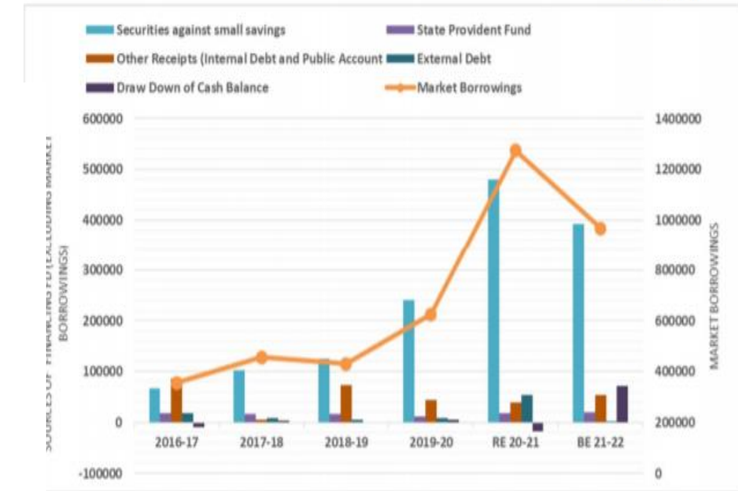


Expenditure



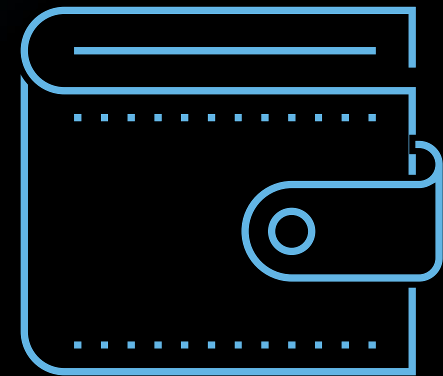
SOURCES OF DEFICIT FINANCING

(₹ in crore)



- Govt needs Rs. 12 lakh crores in gross borrowings
- Fiscal deficit for FYE21 pegged at 9.5%
- Fiscal deficit for FYE22 pegged at 6.8%

Budget 2021-22 theme



6 Pillars of Budget proposals

Need for bold steps to accelerate the economic growth

- The budget proposals were presented in the unprecedented times of the ongoing COVID-19 pandemic situation
- India is faring much better in it's fight against the pandemic with one of the lowest death rates of 112 per million population. Nonetheless, the fight continues in 2021
- The current budget is one of the only three budgets which followed contraction in the economy
- The budget proposals augment the AtmaNirbhar (Self-reliant) packages initiated by the Government in May 2020
- The Budget proposals are targeted towards the government's key priorities: Nation First, Doubling Farmer's Income, Strong Infrastructure, Healthy India, Good Governance, Opportunities for Youth, Education for All, Women Empowerment, and Inclusive Development, among others.

The budget proposals rest on 6 important pillars:

i) Health and wellbeing

ii) Physical & Financial Capital, and infrastructure

iii) Inclusive Development for Aspirational India

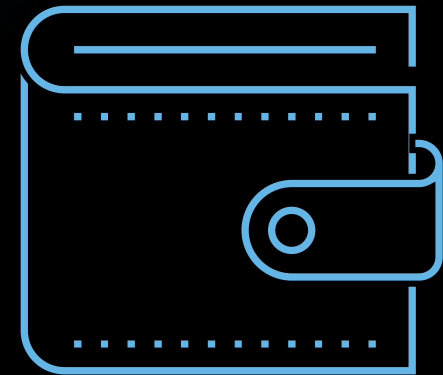
iv) Reinvigorating Human Capital

v) Innovation and R&D

vi) Minimum Government and Maximum Governance

The Government has announced comprehensive measures and budgeted for significant fund allocation for various initiatives to be undertaken under the above 6 pillars.

Direct Tax Proposals



Dividend tax relief

Withholding and advance tax provisions now relaxed

Current Provision

The Finance Act 2020 amended the dividend taxation framework whereby dividends received from Indian Companies (which were earlier exempt in the hands of FPIs) are taxable at the rate of 20% plus applicable surcharge and cess, effective 1 April 2020.

Indian companies are required to withhold tax on such dividend income. The withholding tax provisions for an FPI do not allow Indian companies to apply treaty rates (wherever beneficial). Accordingly, it is mandatory for the Indian company to withhold tax at the statutory rate of 20% plus applicable surcharge and cess.

Wherever lower tax rate under a treaty applies, the excess tax withheld by the company can be utilized against taxes payable on other incomes of the FPI such as the capital gains taxes payable or taxes payable on the interest income from Government securities or reclaimed as a refund from the Indian tax authorities in the annual tax return filed by the FPI.

Proposed amendment

The following amendments have been proposed in relation to dividend income:

- Withholding tax provisions to be amended to enable Indian companies to withhold taxes at treaty rates (wherever beneficial)
- Advance tax liability on dividend income to arise only after declaration / payment of dividend
- Dividend payments to REITs/InVITs by the SPV shall not be subject to withholding tax effective 1 April 2020

A table providing tax rates on dividends under select tax treaties is provided at the next slide.

Taxation of dividends under select treaties

Benefits available to residents covered in the treaty

Country	Rate of tax	Country	Rate of tax	Country	Rate of tax
Australia	15	Ireland	10	Singapore	10[2]/15
Austria	10	Japan	10	Slovenia	5[4]/15
Belgium	15	Korea	15	Spain	15
Canada	15[1]/25	Luxembourg	10	Sweden	10
Cyprus	10	Mauritius	5[4]/15	Switzerland	10
Denmark	15[2]/25	Netherlands	10	UAE	10
France	10	Oman	10[5]/12.5	U.K.	15[6]/10
Germany	10	Russia	10	U.S.A	15[7]/25
Hong Kong	5[3]	Saudi Arabia	5		

[1] BO is a company that controls directly or indirectly at least 10% of the voting power in the company paying dividends

[2] BO is a company that owns at least 25% of the shares of company paying dividends

[3] Subject to the compliance with the Principal Purpose Test in the tax treaty

[4] BO is a company that holds directly at least 10% of the capital of the company paying dividends

[5] BO is a company that owns at least 10% of the shares of the company paying dividends

[6] Dividends paid out of income derived from immovable property by an investment vehicle which distributes most of its income annually and whose income is exempt from tax. Also, subject to compliance with the Principal Purpose Test in the tax treaty

[7] BO is a company that owns atleast 10% of the voting stock of the company paying dividends

Tax exemption to Sovereign Wealth Funds and Pension Funds 1/3

Rationalization of qualifying conditions

Last year, the Indian Government introduced tax exemptions for Sovereign Wealth Funds (SWFs) and Pension Funds (PFs) on their income arising (in the nature of dividend, interest and long term capital gains) from investments made in infrastructure sector in India. The tax exemptions are available subject to satisfaction of certain conditions.

In Budget 2021-22 proposals, certain conditions are proposed to be relaxed:

- **Existing condition**: Presently, investments made by SWFs/PFs in a Category-I or Category-II Alternative Investment Fund (AIF) would qualify for tax exemption provided the AIF invests 100% of its corpus in specified infrastructure entities

  Proposed amendment
  - It is proposed to reduce the investment threshold by AIFs in the specified infrastructure sector entities from 100% to 50%
  - Investments made by AIFs in Infrastructure Investment Trusts would also qualify for the tax exemption
  - Where the investment by AIFs in the specified infrastructure entities is less than 100%, the tax exemption shall be available proportionately

- **Existing condition**: At present, the investments made directly by SWFs / PFs qualify for tax exemption and investments made by Investment holding companies of such SWFs / PFs don't qualify for tax exemption.

  Proposed amendment
  - Investments made by SWF/PFs through holding companies would also qualify for tax exemption provided the SPV is a domestic company set up and registered on or after 1st April 2021 and having minimum 75% investments in one or more infrastructure entities or in an Infrastructure Investment Trust. Further, the tax exemption would be available to the extent of investments made by SPV in infrastructure entities.

Tax exemption to Sovereign Wealth Funds and Pension Funds 2/3

Rationalization of qualifying conditions

- **Existing condition**: Presently, Investment by SWFs or PFs in a Non-banking finance company registered as an Infrastructure Finance Company (NBFC-IFC) and in Infrastructure debt fund (IDF) do not qualify for the tax exemption.

  Proposed amendment

  - Investments by SWFs and PFs in NBFC-IFC and IDFs would qualify for tax exemption provided the NBFC-IFC / IDFs lends at least 90% of it's corpus to infrastructure entities.
  - If the aggregate lending of NBFC-IFC of IDF in infrastructure entities is less than 100%, the tax exemption under this clause shall be calculated proportionately

- **Existing condition**: Presently, tax exemption is not available to SWF/PFs if they have raised funds through loans or borrowings or deposit or investments as there is a condition that no benefit should inure to any private person.

  Proposed amendment

  - SWF/PF shall not qualify for exemption only if SWF/PF has raised funds through loans or borrowings, directly or indirectly, utilized for Indian investments.

- **Existing condition**: No portion of the earnings of SWF / PF should inure any benefit to any private person. Also, the assets of the SWF / PF should vests in the Government of such foreign country upon dissolution

  Proposed amendment

  - These provisions would not apply to any payment made to creditor or depositor for loan taken or borrowing other than for the purpose of making investment in India.

Tax exemption to Sovereign Wealth Funds and Pension Funds

Rationalization of qualifying conditions

- **Existing condition**: There is a condition that SWF / PF should not undertake any commercial activity whether within or outside India. However, the expression “commercial activity” has not been defined.

  Proposed amendment

  - It is proposed to remove the above condition and instead replace it with a condition that the SWF / PF shall not participate in day to day operation of investee entity in India. Further, the monitoring mechanism to protect the investment with the investee including the right to appoint directors or executive director shall not be considered as participation in the day-to-day operations of the investee entity.

- **Existing condition:** One of the conditions for a PF to be eligible for exemption is that the fund should not be liable to tax in such foreign country in which is it is created or established

  Proposed amendment

  - It is proposed to extend the benefit to those PFs that are exempt from taxation in their home country (but are still considered as liable to tax) effective 1 April 2020.

IFSC – Incentives and Relaxations introduced

Fund and the fund manager in IFSC

Existing provision: As per section 9A of the Indian Income tax law, an offshore fund would not be construed to have a business connection or place of residence in India merely because its fund manager is located in India provided the conditions stipulated in the section are met both by the fund as well as the fund manager.

Budget proposal: It is proposed that the Government may issue a notification whereby any or all conditions prescribed in section 9A may not apply or may apply with certain modification to cases where the Fund Manager is located in Infrastructure Financial Services Centre (IFSC) and has commenced its operations on or before 31 March 2024

Tax exemption for offshore banking units

Existing provision: Currently, there is tax exemption available to category III AIFs set up in IFSC on income arising from transfer of all securities other than shares of Indian companies to the extent the income attributable to non-residents

Budget proposal:

1) It is proposed that the investment division of offshore banking unit set up in IFSC would also get registered as Category III AIF and would get similar tax exemptions as available to any other Category III AIF set up in IFSC.
2) It is also proposed to introduce tax exemption to income of a non-resident on transfer of non-deliverable forward contracts entered into with an offshore banking unit set up in IFSC

Tax exemption on gains arising from relocation of offshore fund to IFSC

Existing provision: Currently, any gains arising on transfer of shares of a company resident in India by offshore fund is taxable as short-term capital gain or long-term capital gain under Indian tax laws

Budget proposal: In order to encourage the offshore funds set-up in foreign jurisdictions such as Singapore, Mauritius etc. to shift their operations to India, it is proposed to provide a tax exemption on capital gains to a non-resident on transfer of share of a company resident in India by offshore fund to AIF set-up in IFSC on or before the 31 March 2023, where consideration for such transfer is discharged in the form of share or unit or interest in the resulting fund to the shareholder or unit holder or interest holder of the original fund in the same proportion as was held in offshore fund

Reduction in timelines

Reduction in time limit for re-opening assessments

a) Existing timeline: Presently, the tax authorities can go back up to 6 years (except for cases mentioned in “b” below) to re-open tax assessments have reasons to believe that any income has escaped assessment.

Budget proposal: - The 6-year period is proposed to be amended to 3-years

b) Existing timeline: Presently, the tax authorities can issue notices upto 7 years in case the sum chargeable to tax has escaped or likely to escape assessment is more one INR 0.1 million or upto 16 years where the assets are located outside India.

Budget proposal: Where the tax officer has specified information that the income chargeable to tax, represented in the form of asset which has escaped assessment amounts to or is likely to amount to INR 5 million or more the above time limit for issuance of notice will be 10 years from the end of the relevant assessment year. However, before issuance of such notice an approval by the specified authority will be required.

Reduction of time limit for regular assessments

Existing timeline: At present, the time limit for completion of regular scrutiny assessment is 12 months from the end of assessment year in which the income was first assessable.

Budget proposal: The above time limit is proposed to be reduced to 9 months. Thus, the time for completing of assessment for Assessment Year 2021-22 would be 9 months from the end of the relevant assessment year.

Reduction in the time to file belated return and to revise original return

Existing timeline: Presently, a belated return can be filed or a return can be revised on or before the end of relevant assessment year or before the completion of assessment whichever is earlier.

Budget proposal: The last date for filing of belated or revised return of income, would be reduced by three months. Accordingly, the belated return / revised return would need to be filed within 9 months from the end of the relevant financial year.

Other key amendments aimed at reducing tax litigation & providing clarity

Constitution of Board for Advance ruling

- The existing Authority for Advance Rulings (AAR) pronounces rulings on the applications of the non-resident/residents and such rulings are binding both on the applicants and the Tax department. The existing framework has seriously hampered the working of AAR and a large number of applications are pending since last many years.

- With a view an expedite and provide an alternative method of providing advance ruling which can give rulings to taxpayers in timely manner it is proposed to constitute a Board of Advance Ruling and amend certain provisions of the Authority for Advance Rulings (AAR)

Introduction of faceless assessments to Income Tax Appellate Tribunal (ITAT) proceedings

- In order to impart greater efficiency, transparency and accountability to the assessment process, the Finance bill 2021 has empowered the Central government to formulate a new scheme of faceless assessment for ITAT proceedings

Constitution of Dispute Resolution Committee (DRC) for small and medium taxpayers

- The Finance Bill, 2021 has proposed setting of special DRC for specified assesses as an alternative option to resolve the disputes

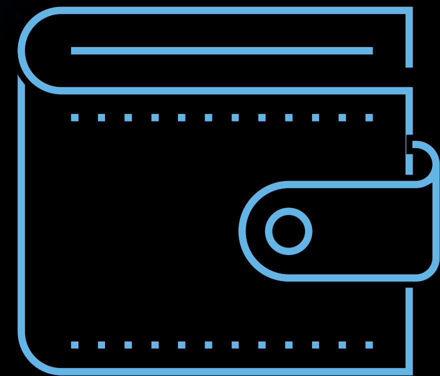
- The DRC would resolve disputes where the returned income is INR 5 million or less (if there is a return) and the aggregate amount of variation proposed in specified order is INR 1 million or less.

Introduction of definition of the term - Liable to tax

- It is proposed to insert definition of the term "liable to tax" in the Indian Income tax law.

- In the proposed definition, "liable to tax" in relation to a person means that there is a liability of tax on that person under the law of any country **and** will include a case where subsequent to imposition of such tax liability, an exemption has been provided.

Annexures



Key tax issues on which representations were made to Government

Representations made by FPIs and other stakeholders

- **Need for common treatment of investment funds**: Representations were made to the Government for 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.

- **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.

- **Indirect transfer tax for Category II FPI investors:** The government should consider amending the law whereby indirect transfer provisions will not apply to transfer of shares / interest in an entity outside India which is triggered from or which results in transfer of securities in India.

- **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 in 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.

- **High tax on derivatives gains:** The government could consider rationalizing the tax rate for exchange traded derivatives to a moderate level of say 15% since such transactions are already subject to securities transaction tax

- **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.

- **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

FPI Tax Rates

Type of Income		Corporate FPIs			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		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-Corporate FPIs (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		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.

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