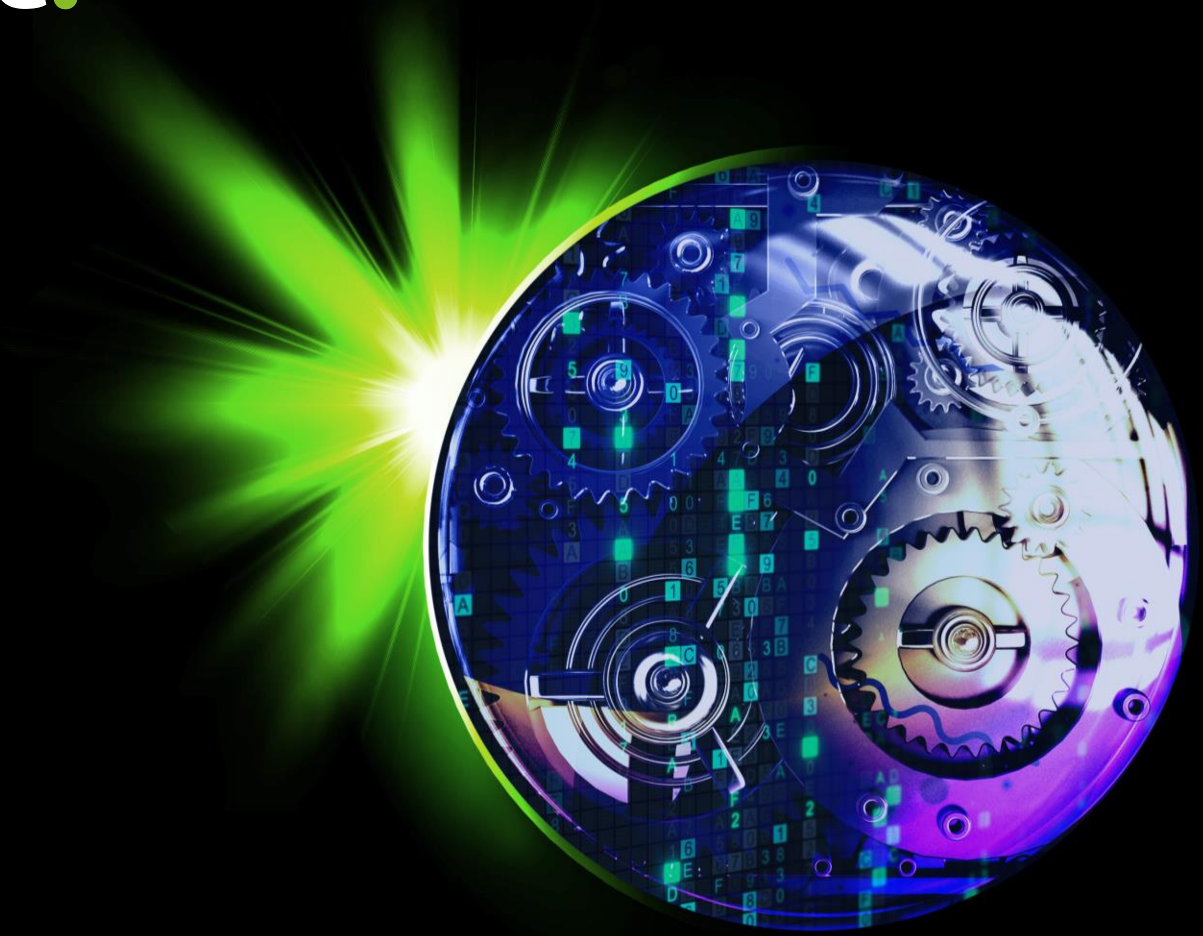
Deloitte.



Union Budget 2021
Towards a thriving India

Private Equity | Real Estate

2 February 2021

Contents

Economic Indicators

Economy: A quick snapshot of the current status

India has shown resilience amidst COVID-19 uncertainties

● Weak outlook ● Strong outlook ● Neutral outlooks

GDP growth

GDP contracted by 7.5 percent in Q2 FY21 after contracting by 23.9 percent in Q1, suggesting the economy is technically in recession.

What to expect in FY21 (growth in percent)

Union Budget: -7.7
IMF WEO: -8.0
Deloitte range: -8.3 to -10.6

Fiscal deficit

Fiscal deficit during April-November 2020 was at 135.1 percent of annual budgeted target.

What to expect in FY21 (in percent of GDP)

Union Budget: 9.5
Deloitte range: 9 to 10.5

Credit growth**

Domestic credit growth fell to 8.5 percent in Q3 FY21 as against 10 percent in Q3 FY20. It even declined from the previous quarter's growth.

What to expect in FY21

Demand for credit growth is likely to remain low because of low economic activity, credit demand, and banks' unwillingness to lend.

Inflation

Inflation (CPI) grew by 6.4 percent in Q3 FY21 compared with 5.8 percent in Q3 FY20. Higher food prices have led to high inflation.

What to expect in FY21 (growth in percent)

Deloitte range: 6
Inflation is expected to decline until the economy picks up sustainably. The RBI will prefer to wait and watch before deciding on further monetary policy easing.

Government's 10-year security yields

Despite uncertainties, post COVID-19 yields have declined to 5.9 percent in January 2021 from its peak at 8 percent in August 2019

What to expect in FY21

Rates may remain volatile with upside risks amidst the COVID-19 crisis and uncertainty regarding economic revival.

Rupee

Rupee appreciated and averaged at INR 73.6 against dollar in December 2020 compared with INR 76.2 per dollar in April 2020.

What to expect in FY21 (INR to US$)

Deloitte range: 74
Rupee may appreciate further as the economy revives and capital flow remains strong.

Current account deficit

Current account surplus fell to 2.4 percent of GDP in Q2 FY21 from a surplus of 3.9 percent of GDP in the previous quarter.

What to expect in FY21 (in percent of GDP)

Deloitte range: 1.7 to 1.9
Expect surplus due to moderated imports even as exports improve.

FDI

Net FDI witnessed an inflow of US$23.3 billion during Q2 FY21 relative to inflow of US$7.3 billion in Q2 FY20.

What to expect in FY21

FDI to remain strong due to high global liquidity, low policy rates in advanced nations, and policy reforms improving ease of doing business.

Note: **Domestic credit is summation of net bank credit to government and bank credit to commercial sector. Growth is measured on year-on-year basis on real values, wherever applicable.
Source: CMIE, RBI, Times of India

Real Estate sector

Real Estate

Taxation on dissolution/reconstitution of partnership firm

Taxation	Existing	Proposed
Distribution of **capital assets** by firm to its partners	Gains arising on distribution of capital asset on **dissolution** of the firm or **otherwise**, to its partner is taxable in the hands of the firm	Provision replaced to cover the following: 1. Dissolution and reconstitution of the firm; 2. Gains arising on the transfer of the asset to be taxable in the hands of firm 3. Computation mechanism to be as follows: - FMV is deemed as full value of consideration - Cost of acquisition is the cost of asset in the hands of the firm/if introduced by partner the FMV at which it was initially taxed (without considering increase in capital account on account of revaluation and self generated goodwill)
Distribution of **money/any other assets** by firm to partners	Basis judicial precedents gains arising on cash distribution not taxable at present in the hands of firm	New provision introduced to also cover distribution of cash/other asset (not characterized as capital asset) on dissolution or reconstitution of the firm. 1. Gains made by partner to be taxable in the hands of the firm 2. Computation mechanism to be as follows: - Money + FMV of asset is deemed to be the consideration - Balance in capital account to be treated as cost (without considering increase in capital account on account of revaluation and self generated goodwill)

Real Estate

Illustration | Taxation on dissolution/reconstitution of partnership firm

Assumptions

Distribution of capital asset/assets/cash by the firm

Particulars	INR
FMV of capital asset distributed	200
FMV of other assets distributed	100
Cash distributed	50
Total Distribution	**350**
Other details	
Balance in the capital account	100
Cost of assets acquired/Cost of asset introduced by Partner	40

Taxation on distribution

Distribution of capital assets to partner

Particulars	Capital gains
FMV of capital asset distributed	200
Less: Cost of acquisition	40
Capital gains taxable in the hands of Firm	**160**

Distribution of other assets/cash to partner

Particulars	Capital gains
FMV of other assets distributed	100
Cash distributed	50
Deemed consideration	150
Less: Cost of acquisition (balance in capital account)	100
Capital gains taxable in the hands of Firm	**50**

Bill proposes to bring in significant amendments to tax distributions from partnership firms to exiting partners. Such distributions have been a subject matter of litigation and the proposed provisions seek to plug room for litigation on taxability of such distributions.

Real Estate

Affordable Housing | Rental Housing | Safe Harbour limits | WHT relaxation

Extending 100% deduction to rental housing projects

Existing law

Deduction available to only affordable housing projects

Proposal

- 100% deduction from profits from business of developing and building rental housing project.
- The projects should satisfy the conditions to be notified by the GOI

Applicable Year: FY21-22

Affordable Housing -> Benefits extended to 31st March 2022

For builders/developers

- Extension of 100% deduction of profits from housing projects approved prior to 31st March 2022

For Individual Buyers

- Interest deduction upto 1.5 lakhs on loan taken from financial institution prior to 31st March 2022

Safe harbor limits available -> Now notified in the Act

Safe harbour limit increased from 110% to 120% of the consideration subject to satisfying below conditions:

- Transfer takes place between 12 Nov 2020 to 30 June 2021
- Applicable on transfer by way of first allotment by builders/developers
- Consideration INR 2 Crore or below

WHT on dividend paid by SPV to REIT

Existing law

Dividend distributed by SPV to REIT is subject to WHT

Proposal

- Exemption is provided to WHT on payment of dividend by SPV to REIT
- Applicable to payments made by SPV in which REIT holds controlling interest and specified percentage as required by REIT regulations

Applicable Year: FY19-20

Summary

Positives

- Access to debt funding from FPIs for REITs/InVITs, relaxation of conditions for SWF and PF investments is expected to increase foreign inflows
- IFSC proposition being made more attractive to attract fund houses and to set up presence in India
- Infrastructure spending to provide indirect booster

Missed expectations

- 'Infrastructure tag' to the RE sector has been overlooked again
- Rationalization of GST provisions relating to input credit on construction costs towards leased properties are yet to be addressed
- Enhancing home loan interest deduction could have increased demand for housing

Private Equity

Private Equity

Exemption on income earned by SWF – Ambit widened

Existing	Proposed relaxations in addition to existing relaxations
Exemption on Dividend, Interest and LTCG earned by SWF / PFs from investments in a) Units of InVIT b) Company developing / operating and maintaining / developing operating and maintaining infrastructure facility ("Infrastructure Companies") c) CAT I and CAT II AIF having 100% investment in companies engaged in infrastructure as covered in point (b) above Exemption is subject to the following conditions : 1. Investment should be made during the period 01 April 2020 to 31st March 2024 2. Investments are held for at least 3 years	**Investment through CAT I & II AIF :** 1. Investment by CAT I & CAT II AIF can be minimum 50% instead of 100% 2. Exemption extended to investment in InVITs through CAT I & II AIFs **Investment through Holding Company and NBFCs** Exemption has been extended to the following investments 1. Investment in holding company registered after 01 April 2021 having minimum 75% investments in Infrastructure Companies 2. Investment in a) NBFC - Infrastructure Finance Company, b) Infrastructure Debt Fund, c) NBFC as referred to in the Infrastructure Debt Fund – Non Banking Financial Companies (Reserve Bank) Directions, 2011, having minimum 90% of lending in Infrastructure Companies Exemption to be calculated proportionately, in case aggregate investment of either the CAT I & II AIF or the Holding Company / NBFC in Infrastructure Companies is less than 100%.

Private Equity

Exemption on income earned by SWF – Ambit widened

Other proposals

Loan or borrowings by SWF / Pension fund

Under the current provisions, the earnings of the SWF was to be credited to the Government of the foreign country and no portion of the earnings could inure any benefit to any private person. Further, the asset of the SWF was to vest with the Government of such foreign country upon dissolution.

The Bill proposes the following:

a) SWF and PFs should not have any loans or borrowings for the purpose of making investments in India.

b) Condition regarding “benefit to private person” and “assets vesting with the Government of the Foreign Country” on dissolution not to apply to any payment made to creditor or depositor for loan taken or borrowing for the purpose other than investment in India

Commercial Activity

Under the current provisions, an SWF carrying out commercial activity was not eligible for the exemption. There was no guidance on what constitutes commercial activity and could have been a subject of litigation and judicial interpretation.

This condition is proposed to be removed and replaced stating that SWF / PF shall not participate in day-to-day operations of the investee company. It is further proposed to be clarified that appointment of director for monitoring investment would not mean participation in day-to-day activities.

Pension Fund – liable to tax

Presently, some pension funds are liable to tax in their home country, though subsequently exempt. Now, it proposed to provide that if pension fund is liable to tax but exemption from all income has been provided by the home country, then such pension funds shall also be eligible for the exemption

Private Equity

IFSC | FPI

IFSC – relocation

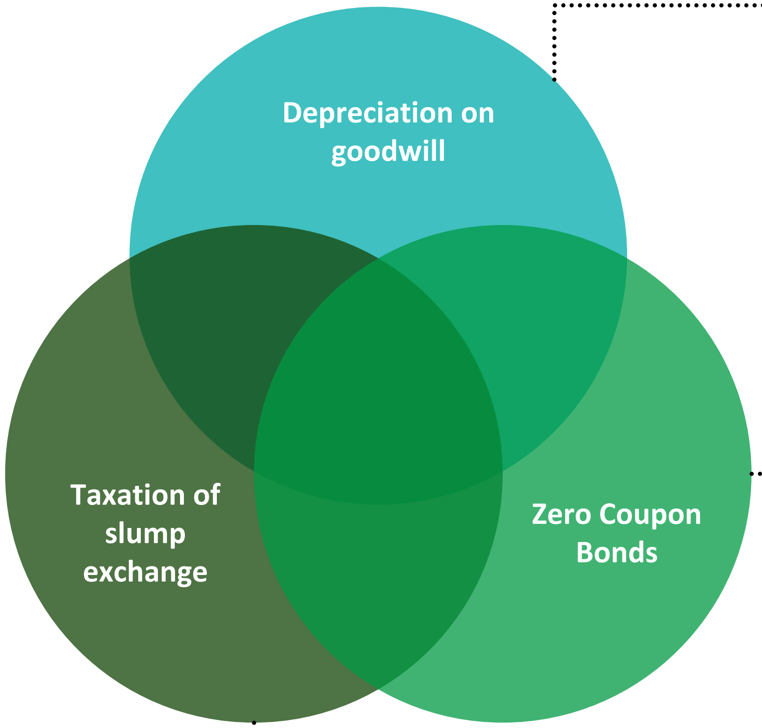
- Relocation of a foreign fund into an IFSC jurisdiction has been incentivized by providing capital gains exemption to both the Fund as well as the members / investors in the fund
- Further the following relaxations are proposed for such relocation:
  - Cost to previous owner shall be available
  - Section 56(2)(x) exemption
  - Section 79 not applicable to a company where change in shareholding has taken place on account of such relocation

IFSC – offshore banking unit and aircraft leasing

- Currently the exemption under section 9A for eligible investment funds is subject to certain onerous conditions. The Bill provides for the Central Government to provide relaxations on applicability of the eligibility conditions for an eligible Investment Fund or its eligible fund manager, provided the fund manager is located in an IFSC and has commenced operations by March 31, 2024.
- Income accrued or received by an investment division of an offshore banking unit, computed in the prescribed manner, is also eligible for an income-tax exemption under section 10(4D) of the IT Act. Further, the definition of the 'specified fund' has been expanded to include an investment division of offshore banking unit which has been granted a category III AIF registration and fulfils other prescribed conditions including the condition of maintaining separate books for its investment division.
- Income accrued/ arisen/ received by a non-resident on (i) transfer of non-deliverable forward contracts entered into with an offshore banking unit of IFSC which commenced operations on or before the March 31, 2024 and fulfils prescribed conditions; and (ii) royalty income arising on account of lease of an aircraft in a previous year, paid by a unit of an IFSC provided such unit is eligible for deduction under section 80LA for that previous year and has commenced operation on or before March 31, 2024.

Other key amendments

Other key amendments



Depreciation on goodwill

- Finance Bill, 2021 seeks to amend the definition of ‘block of asset’ to exclude goodwill of a business or profession
- Further, provisions of section 32 are proposed to be amended to deny claim for depreciation on goodwill
- Claim of depreciation on goodwill has been a subject matter of litigation. This proposed amendment may have a bearing on third party deals and acquisitions

Zero Coupon Bonds

- Finance Bill, 2021 proposes to amendment definition of ‘zero coupon bond’ so as to enable notified infrastructure debt fund also to issue zero coupon bonds.
- Any income paid by infrastructure dent fund in relation to a zero coupon bond shall not be subject to withholding of tax

Slump Exchange

- Finance Bill, 2021 proposed to expand the scope of the definition of the term ‘slump sale’ so as to include transfer of undertakings by any means for lump sum consideration
- This proposed amendment will tax capital gains arising on transfer of undertaking by way of slump exchange or any other means

Other key amendments

Re-assessment procedure

Re-assessment Procedure

- Entire concept of re-assessment is revamped. The concept of ‘reason to believe’ has been dropped
- Reopening to happen only if AO is in possession of information, which suggests that the income chargeable to tax has escaped assessment
- Time limit to re-open has been reduced to 3 years
- The time limit is 10 years where Tax Officer has books of account or other documents or evidence revealing that income, represented in the form of asset, has escaped assessment of INR 50 lakhs
- Information suggesting that income chargeable to tax has escaped includes:
  - Any information flagged in line with the risk management strategy formulated by the CBDT
  - Any final audit objection raised by CAG

Regulatory amendments

Regulatory amendments

Foreign Direct Investment

- FDI in insurance to be increased from 49 percent to 74 percent, subject to having safeguards like majority of Directors on the Board and key management persons to be resident Indians with at least 50 percent of Directors to be independent directors, specified percentage of profits to be retained as general reserve.

AIF / InvIT / REIT etc.

- Definition of "securities" amended to include securities / units issued by PIV or other body corporate. PIV registered with SEBI will be eligible to borrow and issue debt securities.
- PIV permitted to provide security interest to lenders in terms of the facility documents.
- REIT / InvIT are now proposed to be brought under the ambit of the SARFAESI Act.
- Additionally, the Recovery of Debts due to banks and financial institutions Act, 1993 also stands amended to include pooled investment vehicle in the definition of the term 'debt'.

Privatisation / disinvestment

- Privatization of two public sector banks and one General Insurance company proposed in FY21-22 after legislative amendments are made.
- Government has approved policy for strategic disinvestment of public sector enterprises. Niti Aayog to identify more Central Public Sector companies for disinvestment.
- Special Purpose Vehicle in the form of a company will be set-up for monetizing non-core assets mainly comprising of surplus land.
- Stamp duty exemption proposed on transfer of a business or asset or right in any immovable property from a Government Company or any of its subsidiaries/unit/joint ventures to another Government Company

Regulatory amendments

Ease of doing business

- NRIs allowed to incorporate OPCs. OPCs will be allowed to grow without any restriction on capital and turnover. OPCs can be converted into any other type of companies at any time. Residency criteria for Indian citizens to incorporate OPCs have been reduced from 182 days to 120 days.
- e-Courts system will be implemented for strengthening the NCLT framework.
- MCA21 version 3.0 will be launched to facilitate e-scrutiny, e-adjudication, e-consultation and compliance management.
- Proposal to decriminalize offences under the Limited Liability Partnership Act, 2008.

Other financial sector reforms

- Alternate methods of debt resolution and special framework for MSMEs shall be introduced.
- Minimum loan size eligible for debt recovery under the SARFAESI is proposed to be reduced from INR 5 million to INR 2 million for NBFCs with minimum asset size of INR 1 billion.
- An Asset Reconstruction Company Limited and Asset Management Company will be set-up to consolidate and take over the existing stressed debt which can be disposed to AIF and other potential investors for eventual value realization.
- An investor charter to be introduced as a right of all financial investors across all financial products.

Other financial sector reforms

- InvITs and REITs will be allowed to access debt finance from FPIs.
- A professionally managed Development Financial Institution will be set-up to act as a provider, enabler and catalyst for infrastructure financing with an aim to have a lending portfolio of INR 5,000 billion in three years.
- Proposal to consolidate SEBI Act, 1992, Depositories Act, 1996, Securities Contracts (Regulation) Act, 1956 and Government Securities Act, 2007 into a single Securities Markets Code.

Indirect tax amendments

Key indirect tax amendments

GST Annual Returns

- Taxpayers whose annual turnover exceeded INR 5 Crores were mandated to file a GST Audit report certified by a Chartered Accountant or a Cost Accountant
- The above mandate would be discontinued upon enactment
- The annual return and the reconciliation statement to be self-certified by taxpayer
- Since the law is still evolving with constant amendments, the onus is now entirely on the taxpayer to ensure appropriate reconciliations and disclosures.
- This could pose a significant risk as GST continues to remain a self-assessment tax

Input Tax Credit availment

- ITC can be availed only if inward supply reflecting in GSTR-2A
- The buffer which was 20% earlier, then 10% and now 5% will be discontinued.
- Discontinuation of the present buffer of 5% will be make increase cash payment for GST impacting working capital
- The recipient would want to withhold the GST , if the transaction not appearing in GSTR-2A
- Vendor management would now take centre-stage

Key indirect tax amendments

1 Interest payable

- Retrospective amendment on interest applicability w.e.f July 2017
- Interest on delayed payment of tax on outward supplies to be paid on cash payments only
- The benefit only in respect of outward supplies and not for RCM liability or ITC reversal

2 Supply definition

- Principle of mutuality comes under challenge
- Supply by societies, clubs or association to members be covered under supply
- Existence of consideration is a pre-requisite
- The amendment supports the tax position

3 Provisional attachment

- The Commissioner has the power to provisionally attach properties of persons on whom proceedings have been initiated
- The power has been extended to also attach property of the person, with whom the above person has transacted

Key indirect tax amendments

SEZ supplies

- SEZ supplies to be treated as zero-rated only if the same is for authorised operations of the recipient
- Endorsement from specified officer of SEZ unit to be obtained for each invoice
- The supplier could have to pay tax along-with interest and penalty, in absence of endorsements
- Establish nexus between expenses and the authorised operations in order to save the GST outlay
- This could impact supplies to SEZ units, GIFT City, etc.

Restriction on rebate

- Earlier, each exporter was permitted to file a rebate claim
- The rebate option will now be restricted only to notified class of persons or in respect of notified supplies
- This will unsettle the export procedures for exporters
- Payment of integrated tax on exports usually adopted till date for input tax credit accumulated on capital goods

Non receipt of proceeds

- Where consideration for export of goods not received within prescribed timelines, tax payable along-with interest
- While receipt of consideration in foreign exchange is not a pre-requisite for export of goods, this condition makes receipt of consideration within prescribed timelines mandatory

Key indirect tax amendments

1. Introduction of Agriculture Infrastructure and Development Cess (AIDC) such as Coal, Vegetables etc.

2. All conditional exemptions granted under Customs Act, unless specified, shall come to an end on the 31st March falling immediately after 2 years from the date of its grant or variation

3. All existing conditional exemptions, in force on the date of receipt of assent to Finance Bill 2021, shall come to an end on 31 March 2023, unless it has been specifically extended or rescinded, on review

4. Proceedings under Customs Act are to be completed within 2 years (extendable by one year), which culminates in the issuance of SCN under Section 28 of Customs Act

5. A new common portal to be introduced under Customs for facilitating registrations, filing of bill of entry, shipping bills, payment of duty etc.

6. Introduction of new provision under Customs Act prescribing penalty for fraudulent availment of credit for discharging any duty or tax on goods entered for exportation under claim of refund