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Budget: A dampner for NRIs

Finance Minister Arun Jaitley delivered the budget speech in Parliament on Feb 1, with polls to be held by next year

ON FEB 1, India's finance minister presented the country's budget for 2018-19. This is India's last full year budget before the general elections, slated for 2019. It meant that Finance Minister Arun Jaitley had the huge task of considering populist expectations.

At the same time, considering the government's desire to keep its stated promise of staying on the path of fiscal consolidation meant that he had to strike a difficult balance.

Overall, it wouldn't be wrong to say that the budget has clearly focused on the rural and lower strata of Indian society by focusing on areas like agriculture and healthcare for the poor.

However, this has come at a cost to others such as high net worth individuals and non-residents who didn't have much to cheer about.

Looking at the budget through the lens of foreign companies and non-resident individuals, the biggest dampener has been the introduction of long term capital gains on the sale of equity shares and units of equity-oriented mutual funds which until now were exempt from tax, albeit subject to certain conditions.

This move was not something completely unexpected since the pre-budget talk was dominated with these discussions. The budget proposes to levy a tax of 10 per cent on such gains exceeding Rs100,000 with effect from April 1, 2018.

However, gains accruing till Jan 31, 2018 have been grandfathered. Further, units of Real Estate Investment Trusts and Infrastructure Investment Trusts which are listed and sold by non-residents will also suffer the 10 per cent tax. This will come as a blow to both the regimes which are at a very nascent stage in India and impact the institutionalisation process of the real estate and infrastructure sectors including discouraging foreign investors from adopting these.

Looking at the larger picture, this will also pose huge compliance challenges. For example, discharge of taxes and filing of income tax returns will bring them under closer scrutiny of the Indian tax authorities. Further, any distribution made by equity-oriented mutual funds to its investors will now attract a 10 per cent distribution tax.

Similar provisions around long term capital gains have also been proposed for Foreign Portfolio Investors.

But the language of the budget fine print seems to suggest that they may not enjoy any grandfathering benefit for gains accrued till Jan 31, 2018. This seems to be more of an anomaly and one could expect that suitable changes will be introduced before these provisions are enacted.

On the financial services front, to promote the development of world class financial infrastructure in India, it has been proposed to exempt transactions in respect of transfer of certain specified bonds or Global Depository Receipts or derivative instruments undertaken in foreign currency by non-residents on a recognized stock exchange located in any International Financial Services Centre in India.

This change will help in promoting trade in stock exchanges located in such centres.

Rural focus... A digital screen at the Bombay Stock Exchange (BSE) in Mumbai showing Finance Minister Arun Jaitley delivering the budget speech in Parliament. PHOTO: AFP

Another important change pertains to the manner in which non-resident companies might undertake business in India due to expansion in the scope of activities covered within the definition of "business connection" under the current Indian tax laws.

Simply put, income arising to non-resident companies from a business connection in India is taxable in India at a rate as high as 40 per cent (excluding surcharge and cess). However, it does not specifically cover business conducted through a digital mode, without creating some sort of a physical presence in India.

Similarly, it is the conclusion of contracts by an agent on behalf of non-residents that triggers a business connection. With a need to realign the scope of "business connection" with the wider definition of permanent establishment under the Multi-Lateral Instrument framework, it has been proposed to expand the ambit of business connection to include: a) where a person in India plays a principal role leading to conclusion of contracts; and b) where a non-resident has a significant economic presence in India.

With the expected advent of the Multi-Lateral Instrument framework to which India is a party to, it is anyway expected that non-resident companies ranging from the likes of foreign e-commerce players to private equity/venture capital funds will carefully consider the manner in which they do business in India.

However, considering the modalities of the Multi-Lateral Instrument framework, while there is still some time before it comes into effect and therefore non-resident companies from Treaty countries have more time, non-resident companies from non-Treaty countries will have comparatively less time to take a critical look and streamline their operations.

What is also important to note is that the revised definition of "business connection" goes beyond what has been prescribed under the Multi-Lateral Instrument framework. Thus, for example, if an Indian resident were to buy goods or use any services provided by a global e-commerce website like Amazon US and the overall transaction amount in respect of dealings with Indian buyers in aggregate is in excess of the prescribed amounts, Amazon US will be treated as having a "business connection" in India.

Similarly, continuous soliciting of business activities or engaging in interaction with users (number to be prescribed) in India through digital means will also trigger a "business connection" in India.

This will be in addition to the Equalisation Levy or "Google Tax" as it is popularly known, introduced by the Indian Government in 2016.

Lastly, other changes like reduction in corporate tax rates for companies below a certain revenue threshold, rationalisation of tax holiday provisions for start-ups and relaxations for distressed companies could result in more venture capital and private equity funds looking at investing in such companies more favourably.

To conclude, unlike popular perception, in my view, it is not the long-term capital gains tax introduction, but the associated compliances that is the main pain-point for non-residents.

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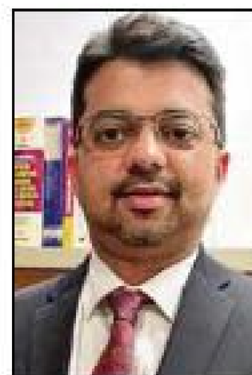

— Saumil Shah (left), a partner at Dhruva Advisors, a company that offers a range of services in the tax and regulatory space, is also a member of the Institute of Chartered Accountants of India. He is a former partner in the tax practice of KPMG and PwC.