India Budget 2016: Key Proposals

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Authors: **Nandan Nelivigi**, **Pradyumna Mysoor**, **David Eisenberg**, **John Cunningham**, **Jonathan Olier**

On February 29, 2016, the Indian Finance Minister presented the Government of India's budget for the fiscal year beginning April 1, 2016. In this alert we summarize the key proposals relevant to international investors investing in India. These proposals will become effective only when the corresponding changes to the relevant laws or regulations are implemented.

FOREIGN INVESTMENT

Asset Reconstruction Companies

- Foreign investors may invest up to 100% in asset reconstruction companies (ARC) without a prior government approval. Under the existing law, foreign investment in ARCs above 49% requires a prior government approval.
- Foreign portfolio investors (FPI) may acquire up to 100% of any security receipts issued by ARCs. Investment by FPIs in security receipts is currently capped at 74%.
- A sponsor of an ARC may hold up to 100% of the equity capital of an ARC. Currently no one can hold more than 50% of the equity capital of an ARC, which is one of the main factors discouraging investments in ARCs. To give effect to this change, the government proposes to amend the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- Trusts set up by ARCs would have a pass through treatment for income tax purposes so that any income received by such trusts would be taxable in the hands of their investors instead of the trusts. Such trusts would be required to withhold applicable taxes.

Investment in Debt Instruments

FPIs may subscribe to unlisted debt securities. Currently, FPIs may invest only in listed debt securities unless they are issued under certain regulations relating to external commercial borrowings (ECB Regulations). It appears that the new proposal may make ECB Regulations relating to rupee-denominated debt securities largely irrelevant. The precise impact would depend on the text of the implementing regulations.

Insurance and Pension

Foreign investors may invest up to 49% in the insurance and pension sectors without a prior government approval but subject to the existing requirement of Indian ownership and control of the relevant business in India. Under the existing law, any foreign investment above 26% and up to 49% in the insurance and pension sectors requires a prior approval of the Foreign Investment Promotion Board and any foreign investment above 49% is not permitted.

Hybrid Instruments

Foreign investors may invest in the capital of Indian companies through hybrid instruments (e.g., debt instruments convertible into equity at the option of the investor) subject to certain conditions under the foreign direct investment policy. Details of these conditions are not yet public. Existing regulations severely limit such instruments, creating significant hurdles to deal structuring in India.

TAXATION

Retrospective Taxation

- The Finance Minister has stated that the Government of India will not amend tax legislation to create retrospective tax liability but there is no proposal to repeal the previous retrospective amendments that created significant unexpected tax liabilities for international investors (see our earlier alert of April 2012).
- Parties to pending proceedings relating to retrospective taxation of income from indirect transfers of shares of Indian companies may settle under the proposed 'one-time scheme of dispute resolution' by withdrawing pending litigation or arbitration against the Government of India, in which case it will only be liable for the applicable tax and not for any interest or penalty.

No deferral of GAAR Implementation

The Finance Minister has reiterated that the General Anti Avoidance Rule (GAAR) will become effective on April 1, 2017. The government has previously stated that the GAAR would apply prospectively to investments made on or after April 1, 2017 and any investments made prior to such date would be protected but the rules are yet to be amended to give effect to this intent.

Long Term Capital Gains

- The holding period for an investment in shares of an unlisted company to qualify as a long term capital asset has been reduced from 3 years to 2 years.
- Long term capital gains tax payable by international investors on the sale of unlisted securities of any company (whether public or private) would be reduced from 20% to 10% effective from April 1, 2017.

White & Case Pte. Ltd.
8 Marina View #27-01
Asia Square Tower 1
018960
Singapore

T +65 6225 6000