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# Highlights of India's 2017 Union Budget

India's budget for 2017 was unique because it changed the tradition of being presented on the last day of February and, for the first time in independent India, the railway budget was combined with the union budget.

However, what was perhaps more unique was that the budget was presented in the wake of tumultuous domestic and international developments. On the domestic side, an amendment to India's constitution has paved the way for a long-awaited and transformational goods and services tax (GST), while the radical move to demonetize large currency notes has caused disruption by slowing down demand and consumption. On the international front, Brexit and the US elections herald signs of increasing protectionism in developed markets for people, goods and services. With this backdrop, India's economic survey for 2017, prepared by chief economic adviser Arvind Subramanian, projected GDP growth for 2017-18 between 6.75% and 7.5%.

Arun Jaitley, India's Finance Minister, presented the budget proposals on 1 February 2017 with the theme "Transform, Energise and Clean India". The budget introduced several measures towards the ease of doing business and contains tax reforms aimed at stimulating growth, promoting digitization and transparency, simplifying tax administration, reducing corporate and personal income taxes, and widening the nation's tax base.

Below are the key policy announcements:

## General

### Abolishing the Foreign Investment Promotion Board (FIPB)

The FIPB, which is an inter-ministerial body responsible for processing foreign direct investment (FDI) proposals, is proposed to be abolished. While most sectors in India have been gradually liberalized and more than 90% of FDI proposals are now processed through the automatic route, this move is another step towards easing the entry of foreign investors.

### FDI Relaxations Expected

Further relaxations of FDI regime are under consideration and amendments to the FDI Policy would be introduced shortly.

### Disincentivising Cash Payments

To encourage digital transactions, the budget provides that no person will enter into cash transactions of INR 300,000 except in certain specified circumstances. For tax purposes, if revenue expenditure incurred in cash exceeds certain monetary thresholds, the expenditure will not be allowed as deduction while computing the total income.

### Listing of Central Public Sector Enterprises (CPSEs)

A mechanism and procedure to ensure time bound listing of identified CPSEs on stock exchanges is to be introduced. The shares of railway public sector enterprises like Indian Railway Catering and Tourism Corporation (IRCTC) and Indian Railway Finance Corporation (IRFC) are proposed to be listed on stock exchanges. A new exchange-traded fund with diversified CPSE stocks and other government holdings will also be launched in 2017-18.

### Dishonoured Cheques

To ensure that the payees of dishonoured cheques are able to realise the payments, the government is considering the option of amending the Negotiable Instruments Act, 1881 suitably.

### New Laws to Deal with Economic Offenders

There will be amendment of laws / introduction of new laws enabling confiscation of assets in India in the case of economic offenders who have fled the country.

### Rationalising of Labour Laws

Labour laws will be rationalized into four codes relating to wages, industrial relations, social security and welfare, and safety and working conditions.

## Financial Sector

### Listing of Security Receipts Permitted

Listing and trading of security receipts issued by asset reconstruction companies is proposed to be permitted on stock exchanges registered under the Security Exchange Board of India (SEBI).This will enhance capital flows into the securitization industry and effectively deal with bank non-performing assets.

### Reforms for Enabling Digital Transactions

The Payment and Settlement Systems Act, 2007 (PSS Act) will be amended for structural reforms in the payments ecosystem. This is in line with suggestions made by the Committee on Digital Payments constituted by the Department of Economic Affairs. The Payments Regulatory Board is to be set up for replacing the existing board. The move aims for greater independence of the supervisory authority under the PSS Act and consequently allows for greater reform to payment systems.

### Joint Working of Regulators

SEBI, the Reserve Bank of India (RBI) and Central Board of Direct Taxes (CBDT) will jointly put in place the necessary systems and procedures to enhance operational flexibility and ease of access to Indian capital markets. A bill on the resolution of financial firms is also to be introduced in the parliament for setting up of a Securities Appellate

Tribunal encompassing several financial regulators, such as SEBI, RBI, Pension Fund Regulatory and Development Authority (PFRDA) and Insurance Regulatory and Development Authority (IRDA).

### Online Registrations for Intermediaries

Common applications for registration and opening of bank and demat accounts and the issue of a Permanent Account Number for financial market intermediaries will be implemented.

### Deepening Capital Markets

Systematically important non-banking finance companies (NBFCs) above a certain net worth will be categorized as qualified institutional buyers by SEBI. This will help the initial public offering market become stronger and channelize more investments into capital markets.

### Protection of Investors

The Multi State Cooperative Societies Act, 2002 is proposed to be revised to protect the investors from dubious/Ponzi schemes.

## Infrastructure

### Affordable Housing Given “Infrastructure” Status

The affordable housing sector will be accorded infrastructure status, which will lead to higher investment in affordable housing and the associated benefits with infrastructure sector will extend to this sector.

### Opening Refinancing Options for Housing Finance

National Housing Bank has been given a budget of about INR 200,000 million (approximately US$ 2.9 billion) in 2017-18 to refinance individual housing loans. Small Industries Development Bank of India (SIDBI) has been encouraged to refinance credit institutions that provide unsecured loans.

### Modenizations of Airports

To upgrade the infrastructure facilities at airports, the Airport Authority of India Act, 1994 is to be amended to facilitate monetization of land assets.

### Introduction of a Metro Rail Policy

A Metro Rail Policy will be introduced with a focus on innovative models of implementation and financing and standardization and indigenization of hardware and software. A new Metro Act will be introduced for private participation and investment in construction and operation.

### Resolution of PPP Disputes

The Arbitration and Conciliation Act, 1996, will be amended to streamline institutional arrangements for resolution of disputes in infrastructure-related construction contracts, public-private partnerships and public utility contracts.

## Food, Farming and Consumers

### Contract Farming

A Model Act on contract farming law will be introduced for adoption by states with the view to ensure better price realization for farmers.

### Availability of Drugs

The Drugs and Cosmetics Rules will be amended to ensure the availability of drugs at reasonable prices and to promote the use of generic medicines.

### Medical Devices

A new regulatory framework for medical devices will be introduced in harmony with international standards to attract investments and enhance the affordability of devices.

### Work Opportunities for Women

To provide employment opportunities for women and with focus on the ease of doing business and adoption of modern business practices, the Model Shops and Establishment Bill, 2016, has been shared with the states for their consideration and adoption.

## Tax Proposals

### Implementation of GST

The implementation of GST is on schedule and the states and central government have been working to give a finishing touch to the Model GST law and rules. The Indian government will make extensive efforts to spread awareness of the new taxation system with trade and industry members from 1 April 2017. GST is likely to spur growth and competitiveness, and lead to indirect tax simplification and greater transparency. Apart from widening of the tax net, GST will also contribute significantly to the GDP.

### General Anti-Avoidance Rules (GAAR)

No changes have been proposed in the General Anti-Avoidance Rules (GAAR) provisions. Thus, GAAR provisions would come into force with effect from 1 April 2017. GAAR confers broad powers on Indian tax authorities to deny tax benefits, including tax benefits applicable under tax treaties, if the tax benefits arise from arrangements that are “impermissible avoidance arrangements”.

### Reduction in Personal and Corporate Tax Rates

The rate of income tax is proposed to be reduced to 5% (from 10%) for income between INR 250,000 (approximately US$ 3,676) to INR 500,000 (approximately US$ 7,352).

The income tax rate for companies with annual turnover up to INR 500 million (approximately US$ 7.3 million) is proposed to be reduced to 25%. This is a continuation of last year’s proposal of reducing corporate taxation and is expected to affect nearly 96% of companies in India. This is a welcome move for small and medium enterprises, many of which were adversely affected by demonetization.

### Encouraging Real Estate Investments

The holding period in respect of immovable properties to qualify as long-term capital assets has been proposed to be reduced to 24 months from 36 months. The base year for computation of capital gains for old capital assets acquired before 1 April 1981 has been proposed to move to 1 April 2001.

## Relaxation for Affordable Housing Projects

Relaxation has been proposed in the conditions to qualify for 100% profit-linked deduction in the business of developing qualifying affordable housing projects. These are as follows: (i) the size of residential unit will be measured as "carpet area"* and not as "built-up area,"; (ii) completion of project for claiming deduction will be increased from three years to five years from receipt of approval, and (iii) the size restriction of 30 square metres (323 square feet) for residential units shall apply only to metro cities (i.e. municipal limits of Chennai, Delhi, Kolkata and Mumbai).

## Encouraging Digital Transactions

At present, 8% of the turnover of SMEs whose turnover is up to INR 20 million (approximately US$ 294,117) is counted as presumptive income. This limit is proposed to be reduced to 6% in respect of turnover which has been generated by non-cash means. This will incentivize the small and medium enterprises to make transactions through digital means.

## Relief for Foreign Portfolio Investors (FPIs) From Indirect Transfer Provisions

It has been clarified that indirect transfer provisions under the Income Tax Act (ITA) will not be applicable to investment held by non-residents, directly or indirectly, in Category I or Category II foreign portfolio investments. This amendment is applicable with retrospective effect from 1 April, 2012. This exemption would result in indirect transfer provisions not being applicable in case of redemption of shares or interests outside India as a result of or arising out of redemption or sale of investment in India which is chargeable to tax in India.

## Tax Benefits for Start-ups

Under the existing provisions under the ITA, 100% deduction of the profits and gains derived by an eligible start-up, which are set-up before 1 April 2019 from eligible business involving innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property, is allowed, subject to other prescribed conditions. Such deduction is allowed for any three consecutive years, out of five years beginning from the year in which such start-up is incorporated. In light of the fact that start-ups may take time to earn profits from their business, such deduction is proposed to be allowed for any three consecutive years, out of seven years beginning from the year in which such start-up is incorporated.

Eligible start-ups will also be allowed to carry forward losses incurred in any prior year and set off against income of the previous year, only if all the shareholders holding shares in the prior year continue to hold those shares in the year of set off as well.

## Withholding Tax Concession Extended to Rupee Denominated (Masala) Bonds

The current concessional withholding rate of 5% on interest earned by foreign entities on external commercial borrowings is being extended to rupee denominated (masala) bonds. Further, while this concession is available until 30 June 2017, it is being extended until 30 June 2020. These changes will be beneficial in respect of increasing rupee denominated issuances and external commercial borrowings (ECBs) raised by Indian companies.

## Long-term Capital Gains: Restrictions on Exemptions Introduced

Currently, transfer of a long-term capital asset that is an equity share of a company is exempt from capital gains tax provided the transfer has been subject to STT. The budget proposes that in relation to equity shares acquired on or after 1 October, 2004, exemption from capital gains on transfer shall be available only where STT was paid at the time of acquisition also. However, certain exceptions are expected like acquisition of shares in IPO, FPO, bonus or rights issue by a listed company, acquisition by nonresidents in accordance with FDI policy etc., through a notification.

## Conversion of Preference Shares Into Equity Shares to be Tax Exempt

Under the extant provisions under the ITA, the conversion of a bond or debenture of a company into equity shares is specifically exempt from capital gains tax, but such a conversion of preference shares is not. In order to maintain parity, a similar benefit is proposed to be extended to the conversion of preference shares of a company into equity shares. It is proposed that the cost of acquisition and period of holding of the preference shares shall be considered while determining the cost of acquisition and period of holding of equity shares acquired on such conversion.

## Shifting the Base Year from 1981 to 2001

Currently, indexation benefit is available on cost of acquisition and cost of improvement for assets classified as long-term while computing capital gains. Further, for assets purchased prior to 1 April 1981, the cost of acquisition is either the fair market value of the asset as on 1 April 1981 or the actual cost, at the option of the assessee. With a view to reduce the difficulties faced by the assessee with respect to availability of information for fair market value as on 1 April 1981, it is proposed to change the base year to 2001.

## Cost of Acquisition in Tax-neutral Demerger of Foreign Company

Under the existing provisions under the ITA, transfer of shares of an Indian company in a demerger of a foreign company to another foreign company is exempt from tax. With a view to rationalize the provisions, it is proposed that the cost of acquisition of shares of the Indian company in the hands of the demerged foreign company shall be considered as the cost in the hands of the resulting foreign company.

## Clarification in Regards to Tax on Transfer of Unlisted Securities by Non-resident

The budget clarifies that the concessional tax rate of 10% for non-residents in respect of long-term capital gains arising out of transfer of unlisted securities of Indian companies is available from 1 April 2012.

## Proposed Amendments to Tax Receipt of Cash or Property Without Adequate Consideration

Currently, the anti-abuse provisions of section 56(2) of the ITA for receipt of money or property without consideration or inadequate consideration are applicable only to individuals and in some specific cases, to firms and companies. In order to cover all types of assesses under the scope of this section, it is proposed to insert a new clause (i) to provide that receipt of the sum of money or the property by any person from any other person without consideration or inadequate consideration in excess of INR 50,000 shall be chargeable to tax in the hands of the recipient under the head "Income from other sources." Exceptions are provided in respect of specified situations similar to those covered in current section 56(2)(vii) of the ITA, such as receipt of money from relative, under will, etc.

## Special Provisions for Joint Development Agreements (JDA)

The budget has provided relief to land owning individuals by proposing to suitably amend the ITA in a manner which specifies that, in case of any transfer of land/building by an individual or under a JDA, the liability on the transferor to pay capital gains tax will arise in the year in which the project is completed. The proposed amendment provides much needed clarity regarding the timing of the taxable event and should contribute towards reducing litigation on this subject.

## Introduction of Thin Capitalization Rules

The budget proposes to introduce thin capitalization rules within the ITA to curb companies from enjoying excessive interest deductions, while effectively being similar to an equity investment. It proposes the introduction of a new clause to provide that, where an Indian company makes interest payments to its associated enterprise, such interest shall not be deductible at the hands of the Indian company to the extent the interest amount exceeds 30% of its EBITDA. The provisions are an outcome of the BEPS Action Plan 4 adopted by the Organisation for Economic Co-operation and Development (OECD) which proposed a 10% to 30% of EBITDA range for limitation on interest payments in intra-group transactions.

Fair Market Value to be Substituted as Full Value Consideration in Cases Where Consideration is Less Than Such Fair Value

Under the current provisions under the ITA, the value adopted for stamp duty purposes can be substituted as the full value of consideration for computing capital gains on transfer of immovable property where the consideration received or accruing is less than such value. A similar provision is proposed to be introduced for transfer of shares other than quoted shares (as defined) under which the fair market value of such shares will be substituted as full value of consideration in case the consideration received or accruing is less than the fair market value. Rules to determine the fair market value of such shares will be prescribed.

## Place of Effective Management (POEM)

No changes have been proposed with respect to the POEM criteria for tax residency of foreign companies. Thus, the provisions pertaining to POEM would continue to be applicable with effect from 1 April 2016. The Central Board of Direct Taxation (CBDT) has recently issued Circular No. 6 of 2017, dated 24 January 2017, laying down the final guidelines for the determination of the POEM of a foreign company. The final guidelines take forward the concept laid down in the draft guidelines for POEM determination based on the bifurcation of companies engaged in active business outside India and other companies. It further provides clarification on certain key areas. A few illustrations have also been provided to highlight the applicability of principles enumerated in the guidelines. A notification with respect to applicability of various provisions to a foreign company, which is treated as a resident on account of its POEM being in India, is still awaited.

## Proposed Amendments to Clarify Interpretation of Terms Used in a Tax Treaty

Under sections 90(1) and 90A(1) of the ITA, the Central Government is empowered to enter into tax treaties with other jurisdictions for granting relief in respect of doubly taxed income. It is now proposed that where any term used in a tax treaty is defined therein, the said term shall be assigned the same meaning, and where the term is not defined in the tax treaty but defined in the ITA, it shall be assigned the meaning under the ITA and any explanation issued by the Central Government.

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