UPDATES

Budget 2024: Key highlights for non-resident investors

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On 23 July 2024, the Finance Bill 2024 (**Bill**) was introduced proposing sweeping changes to the Income Tax Act, 1961 (**Act**), with an aim to transform the tax landscape in India by simplifying tax regulations, enhancing taxpayer services, and fostering economic growth.

From a mergers and acquisitions perspective, the Bill proposes to streamline the capital gains tax regime through rationalisation of the holding periods for assets and adjustment in capital gains tax rates. These changes are intended to simplify the tax process and make capital gains more predictable and transparent especially for non-residents.

To address a long-standing concern for unregistered startups and investors, the Bill seeks to abolish the angel tax provisions. It also proposes to revise the taxation of corporate gifts and buyback of shares. These amendments reflect a broader strategy to create a more transparent and efficient tax environment.

In order to promote the development of world-class financial infrastructure in India, several tax concessions have been provided under the Act to units located in International Financial Services Centre (**IFSC**). The Bill has now proposed an exemption to retail funds and exchange traded funds (**ETF**) set up in IFSC.

Overall, the Bill is a positive step towards encouraging investment, reducing litigation, and supporting economic development in India.

This update highlights key proposals under the Bill impacting non-resident investors investing in India.

1 Abolition of angel tax

The Finance Act, 2012 introduced angel tax to prevent the generation and circulation of unaccounted money, by taxing unlisted companies issuing securities at a super premium (i.e., consideration paid in excess of the fair market value) to resident investors. In 2023, its ambit was expanded to also tax Indian companies issuing shares to non-resident investors.

The Bill proposes to abolish the angel tax to enhance tax certainty and significantly reduce future litigation. This change will simplify transactions by alleviating the complexities associated with obtaining tax valuation reports in sync with the valuation report required under the foreign exchange regulations which may use a different method for determining fair value of the shares. Pertinent to note that the Revenue authorities can still tax super premium under Section 68 of the Act in the hands of the company if the source of the investment from residents is not adequately explained. Therefore, companies must maintain proper documentation to safeguard themselves from this risk.

Overall, the removal of angel tax is a positive proposal and will encourage entrepreneurship and innovation. It will also align India's tax regime with international standards and make it more attractive for foreign investments. This amendment is proposed to be made effective from 1 April 2024.

2 Capital gains tax regime overhauled

2.1 Overall period of holding for capital assets rationalised

Depending on the nature of the capital asset, the Act currently prescribes different holding period thresholds (12/24/36 months) for classifying a capital asset as a short-term or a long-term capital asset.

The Bill proposes to simplify the capital gains tax regime by providing only two minimum holding periods – 12 months and 24 months - to determine whether a capital asset qualifies as a short-term or a long-term capital asset, other than assets which are deemed to be short term capital assets irrespective of the period of holding.

2.2 Specific treatment for certain categories of assets

The Bill proposes that the gains arising on the transfer, redemption or maturity of unlisted bonds and debentures, be deemed to be short term capital gains (**STCG**), irrespective of the holding period and taxed accordingly. This amendment will ensure that the gains arising on the transfer, redemption or maturity of unlisted bonds and debentures are treated in the same way as market-linked debentures and units of '*Specified Mutual Funds*'.

All listed securities including units of listed business trusts (real estate investment trusts (**REIT**) and infrastructure investment trusts (**InVIT**)), are now proposed to be treated at par by providing a reduced holding period of 12 months to qualify as long term. The benefit of long term capital gains (**LTCG**) tax rate is likely to encourage investments in business trusts and make them a lucrative investment avenue.

A reduced holding period of 24 months has been proposed for capital assets such as partnership/limited liability partnership interest, gold, etc., for which the period of holding to qualify as long term was previously 36 months. This amendment would be specifically beneficial when undertaking the transfer of a business undertaking by way of slump sale, where the business undertaking is held for more than 24 months.

2.3 Changes in capital gains tax rates

The Bill proposes a tax rate of 12.5% to apply to LTCG arising from the transfer of all categories of long-term capital assets (except unlisted bonds, unlisted debentures, '*Specified Mutual Funds*' and market-linked debenture, gains from which would be deemed to be STCG, as discussed above).

Further, the exemption from income tax on the LTCG of up to INR 1 lakh on equity shares, units of equity-oriented funds and units of a business trust is now proposed to be increased to INR 1.25 lakh.

While these changes to the capital gains tax regime are welcome, the Bill proposes to increase the concessional tax rate of 15% applicable to listed shares, units of equity-oriented funds and units of business trusts to 20%. STCG arising from any other short-term capital asset is proposed to continue being taxed at the tax rates applicable to the taxpayer.

Consequential amendments have also been proposed for special provisions dealing with taxation of certain non-residents such as foreign portfolio investors, overseas financial organisations (offshore funds) and certain capital assets such as global depository receipts.

The table below summarises the proposed amendments to the capital gains tax regime with respect to listed and unlisted shares and securities

Capital asset	Nature of capital gain	Proposed holding Period	Existing holding Period	Proposed tax rate	Existing tax rate
Listed equity	Short-term	<=12 months	<=12 months	20%	15%
	Long-term	>12 months	>12 months	12.5%	10%
Listed units of business trusts (REITs/InVITs)	Short-term	<=12 months	<=36 months	20%	15%
	Long-term	>12 months	>36 months	12.5%	10%
Listed bonds and debentures	Short-term	<=12 months	<=12 months	Slab rate	Slab rate
	Long-term	>12 months	>12 months	12.5%	10%
Listed securities (*other than discussed above*)	Short-term	<=12 months	<=36 months	Slab rate	Slab rate
	Long-term	>12 months	>36 months	12.5%	20%
Unlisted equity	Short-term	<=24 months	<=24 months	Slab rate	Slab rate
	Long-term	>24 months	>24 months	12.5%	Resident – 20% with indexation Non-resident – 10%
Unlisted bonds and debentures	Short-term	Deemed to be short-term	<=36 months	Slab rate	Slab rate
	Long-term		>36 months	Slab rate	20%
	Short-term	<=24 months	<=36 months	Slab rate	Slab rate

Capital asset	Nature of capital gain	Proposed holding Period	Existing holding Period	Proposed tax rate	Existing tax rate
Unlisted securities (other than discussed above)	Long-term	>24 months	>36 months	12.5%	Resident – 20% with indexation Non-resident – 10%

These amendments are proposed to be made effective from 23 July 2024.

3 Clarification to the definition of '*Specified Mutual Funds*'

The Act classifies income from the transfer, redemption, or maturity of units of a '*Specified Mutual Fund*' as short-term capital gains. A '*Specified Mutual Fund*' is defined as a mutual fund where not more than 35% of its total proceeds are invested in the equity shares of domestic companies. Given that offshore funds, ETFs, Gold Mutual Funds, Gold ETFs and Fund-of-Funds (**FoF**) are not debt-oriented funds, but invest less than 35% in equity shares of domestic companies, there has been a degree of ambiguity and confusion on the application of the definition of Specified Mutual Fund, to such non-debt oriented funds.

Addressing this, the Bill proposes to amend the definition of '*Specified Mutual Fund*' to provide that a '*Specified Mutual Fund*' is: (i) a mutual fund that invests more than 65% of its total proceeds in debt and money market instruments, or (ii) a fund that invests 65% or more of its total proceeds in the fund mentioned in point (i), i.e., FOF. This amendment is proposed to be made effective from 1 April 2025.

Additionally, it is clarified that debt and money market instruments include securities classified or regulated by the Securities and Exchange Board of India (**SEBI**), indicating that Section 50AA would apply primarily to India-focused funds. Therefore, investments made by a fund in offshore ETFs will not be governed as per Section 50AA.

To summarise:

S.No.	Name of Fund	Existing tax implications (FY 2024-25)	Proposed tax implications (FY 2025-26)
1.	ETFs, Gold Mutual Funds, Gold ETFs (< 35% in equity shares)	Deemed to be short-term capital gains, taxable at normal slab rate	Long-term: Taxable at the rate of 12.50% Short-term Taxable at the normal slab rate
2.	Debt Mutual Fund (More than 65% in debt instruments)	Deemed to be short-term capital gains, taxable at normal slab rate	

4 Revamping buyback taxation: new rules ahead

Before the introduction of buyback tax in 2013, cancellation of shares was taxable as capital gains. However, it was found that some shareholders investing monies from tax havens were circumventing this. To address this, buyback tax was introduced by the Finance Act, 2013, taxing buybacks for unlisted shares. Over time, its reach expanded, and by 5 July 2019, it also included the buyback of listed shares. According to these provisions, companies were required to pay tax on buying back shares. The tax paid by the company was treated as final payment of tax and such income was exempt in the hands of the shareholders.

The Bill proposes to overhaul the existing tax regime by treating the amount paid on the buyback of shares as a deemed dividend, taxable in the hands of the shareholders at applicable tax rates. It also proposes that appropriate taxes must be withheld while making payments to resident shareholders. The cost of acquisition of shares cancelled pursuant to buyback will be considered as a capital loss and allowed to be carried forward. Such capital loss can be set off against capital gains earned in the future. However, there seems to be a procedural lapse in confirming that the capital loss will be available for carry forward for a period of eight financial years similar to capital losses arising on the transfer of other shares and securities. Also, investors who do not frequently invest in India may find it difficult to set off capital losses. The government could have considered taxing buyback price after allowing cost of acquisition so that the shareholder is not required to wait for earning gains to claim a set-off.

This amendment, proposed to be made effective from 1 October 2024, places the buyback option on equal footing with other methods of profit repatriation, such as dividends and capital reduction. Non-resident shareholders will be able to avail credit of taxes withheld in its home jurisdiction which could not have been possible earlier.

5 Corporate gifts taxable in the hands of the transferor

Currently, the transfer of capital assets by way of gifts are not considered taxable transfers and are therefore outside the ambit of capital gains tax. However, this issue has been a subject of litigation over the years due to concerns over such transfers being used as a means of tax avoidance. Further, the courts have recognised that gifts (albeit under the Indian Contract Act,1862) are to be made out of natural love and affection between parties which is not possible between corporates.

The Bill proposes to address this concern by limiting the exemption to individuals or Hindu Undivided Families. Therefore, gifts made by companies will be considered taxable transfers subject to capital gains tax. To determine capital gains, the fair value of shares will be deemed to have been received by the transferor company going forward.

This amendment is proposed to be made effective from 1 April 2024.

6 Reduction in tax rate for foreign companies

The Bill suggests lowering the corporate tax rate for foreign companies from 40% to 35% from 1 April 2024. This is a significant change for foreign companies having a branch office, project office or Permanent Establishment (**PE**) (in any other form) in India. However, certain income streams, such as interest, fees for technical services (**FTS**), LTCG, and dividends are subject to specified rates under the domestic tax laws read with the applicable tax treaty, and would therefore remain unchanged. The current rate of surcharge and cess will also continue to remain the same.

7 Thin capitalisation rules not applicable to finance companies located in International Financial Services Centre

Section 94B of the Act disallows '*excess interest*' paid by an Indian company or a PE of a foreign company in respect of any debt issued by a non-resident associated enterprise as a deduction from taxable income. '*Excess interest*' means an amount exceeding 30% of the EBITDA (i.e., earnings before interest, taxes, depreciation, and amortization) of such Indian company or a PE of a foreign company.

Currently, the provisions of this section do not apply to Indian companies or PE of foreign companies engaged in the business of banking or insurance or non-banking financial companies. Under the Bill, this benefit has been extended to finance companies located in IFSC subject to certain conditions being met. Therefore, the interest amount paid by such finance companies can be claimed as a deduction while computing income tax payable.

This amendment is proposed to be made effective from 1 April 2024.

8 Venture capital funds and venture capital companies not required to explain their source of funds, if regulated by the International Financial Services Authority

The Act provides that where any sum is credited in the books of an investee company for which the company cannot offer an explanation or provide a satisfactory explanation about its nature and source, then such sum can be taxable in the hands of the investee company. However, such funds will be treated as explained if the investor/entry provider can explain the source of the funds invested in the investee company. This additional proof of satisfactorily explaining the source in the hands of investor/entry provider does not apply if the entry provider is a venture capital fund (**VCF**) or venture capital company (**VCC**) registered with SEBI.

The Bill proposes to extend the benefit of this relaxation to VCFs and VCCs regulated by the International Financial Services Centre Authority (**IFSCA**) as well.

This amendment is proposed to be made effective from 1 April 2024.

9 The Amnesty Scheme (Direct Tax Vivad se Vishwas Scheme, 2024)

The direct tax laws provide for a comprehensive mechanism for appeal, both by the taxpayer and the tax department, before various appellate authorities. Due to the rise in the number of pending appellate litigations, the Bill proposes to reintroduce an amnesty scheme.

The objective of this scheme is to provide a mechanism for expeditious settlement of appeals pending as on 22 July 2024, thereby reducing litigation without much cost to the exchequer. The date of enforcement of this scheme is yet to be notified by the government.

The Scheme allows taxpayers to settle their pending appeals by paying the disputed tax, interest, or penalties at rates lower than the rates prescribed by the Act. The table below provides an overview of these lower tax rates.

Nature of tax arrear	Applicable time period for appeal proceedings	Amount payable on or before 31 December 2024	Amount payable on or after 1 January 2025 but before 'last date'
Aggregate of disputed tax, interest and penalty	Appeal filed after 31 January 2020 but on or before 22 July 2024	Disputed tax	110% of disputed tax
Aggregate of disputed tax, interest and penalty	Appeal filed before 31 January 2020 and the appeal is pending before the same forum/authority	110% of disputed tax	120% of disputed tax
Disputed interest, penalty or fee	Appeal filed after 31 January 2020 but on or before 22 July 2024	25% of (disputed interest or penalty or fee)	30% of (disputed interest or penalty or fee)
Disputed interest, penalty or fee	Appeal filed before 31 January 2020 and the appeal is pending before the same forum/authority	30% of (disputed interest or penalty or fee)	35% of (disputed interest or penalty or fee)

Notably, the amount payable under columns 3 and 4 above would be reduced by half if the appeal/writ petition/special leave petition has been filed by the income tax authorities or where the issue in the appeal has already been decided in favor of the taxpayer by the Income Tax Appellate Tribunal/High Court (and has not been reversed).

The reintroduction of the amnesty scheme will enable taxpayers to obtain a quick resolution of their disputes with the income tax authorities and reduce tax uncertainty caused by the time taken to conclude appellate proceedings. This would also reduce the burden of pending litigations before the various appellate authorities.

10 Hike in securities transaction tax on the sale of futures and options

The Bill proposes increasing taxes on futures and options trading.

Below is a comparative table discussing the hike in securities transaction tax on futures and options trading:

Particulars	Rates applied on	Existing rates	Proposed rates
Sale of options	Value of option premium	0.0625%	0.1%
Sale of futures	Value at which futures are traded	0.0125%	0.02%

This amendment is expected to marginally increase the cost of trading in futures and options from 1 October 2024.

11 Specified income of Core Settlement Guarantee Funds set up by recognised clearing corporations in IFSC to be exempted

Under the Act, certain income of Core Settlement Guarantee Funds is not taxable in the hands of such fund. However, this exemption is restricted to Core Settlement Guarantee Funds set up by recognised clearing corporations registered with SEBI.

Acknowledging that the IFSC operates two clearing corporations of its own, the Bill proposes to include Core Settlement Guarantee Funds set up by clearing corporations registered with the IFSCA within the above exemption.

This amendment is proposed to be made effective from 1 April 2024.

12 Equalisation levy

The Finance Act, 2016 introduced an equalisation levy at the rate of 6% (**6% EL**) on the payments made for online advertising services and other specified services or goods provided by non-residents. Subsequently, the Finance Act, 2020 expanded the scope of the equalisation levy and introduced a levy of 2% (**2% EL**) to cover a broader range of services, including digital and online services beyond just advertising. The 2% EL applies to non-resident e-commerce operators who have a significant digital presence in India. Further clarifications were provided to ensure that where the payment is taxable as royalty or fees for technical services (**FTS**) under the Act read with the relevant tax treaty, the provisions of 2% EL would not apply.

In line with a press statement by the Ministry of Finance in November 2021 assuring the withdrawal of the 2% EL, the Bill proposes to abolish it with effect from 1 August 2024. However, the 6% EL is still chargeable on the consideration receivable by a non-resident for online advertising services and other specified services.

The Bill appears to be increasingly geared towards providing a more conducive tax regime for corporations to conduct business in India. While there has been a marginal increase in the tax rate for long term capital gains and for listed short term capital gains, the overall simplification in the capital gains tax regime was necessary. The GIFT IFSC continues to receive preferential treatment from the government, with IFSCA-regulated ETFs and retail funds now included in the specified fund status, benefiting from specific tax exemptions. This is likely to attract more fund managers to set up operations in IFSC.
