Budget Connect 2018

Impact on Private Equity/ Venture Capital Sector

EY
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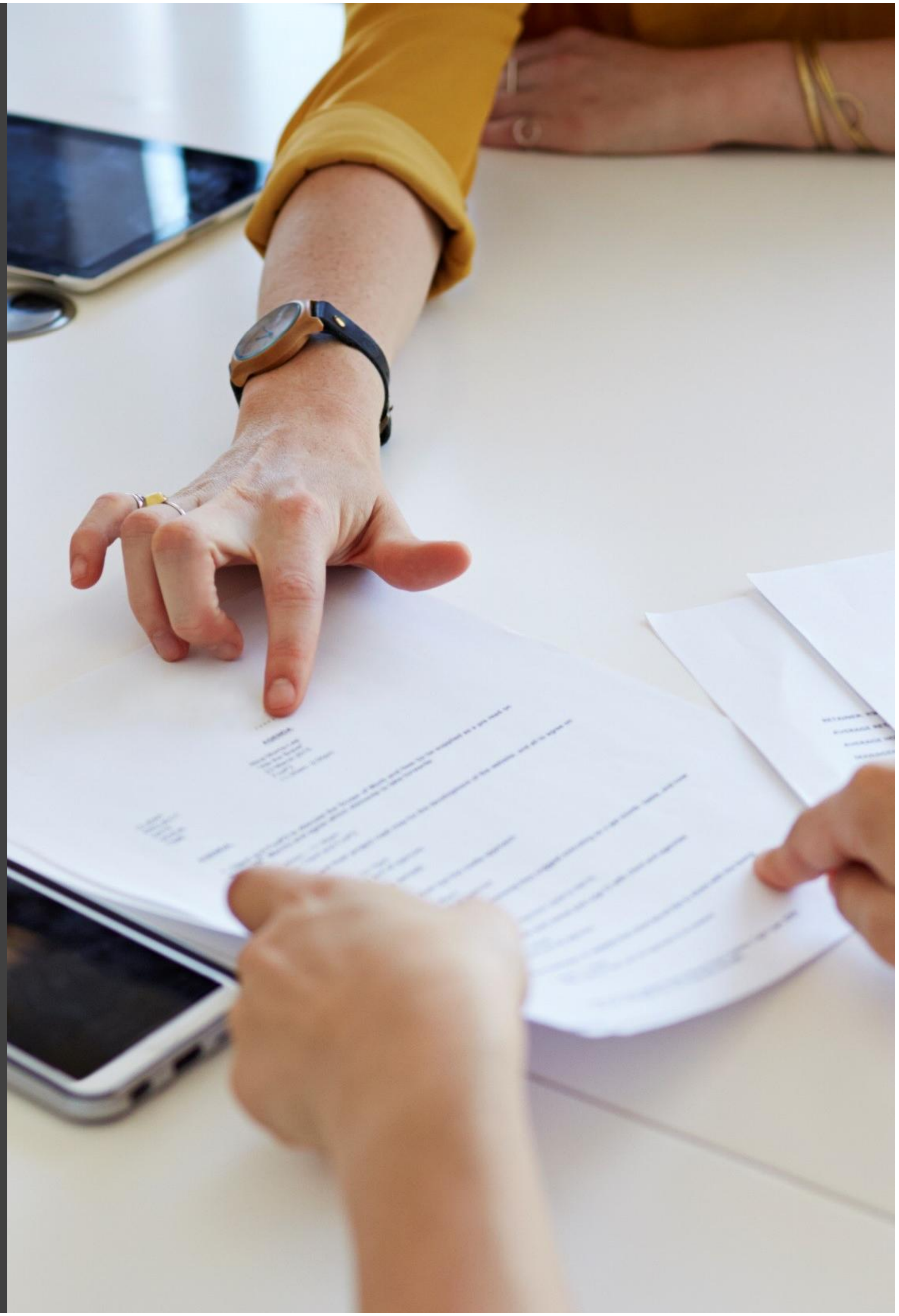
Contents



01 Budget Backdrop

Budget Backdrop

- 2017 was a record year for PE/VC investments in India recording a new all-time high of US$26.8 billion. In value terms investments rose by 65.4% compared to 2016
- All the major sectors recorded significant increase in value invested in 2017, compared to the previous year, and was the best year in terms of value of investments for most of the top sectors
- FS, Real Estate, E commerce, Technology, Retail and Consumer Products, and Healthcare recorded highest ever investments by PE/VCs in India, together accounting for 78% of all investments made during the year
- In terms of Exits too, 2017 was the best year for both deal value and volume. Buoyant capital markets led a big increase in open market exits and PE backed IPO’s.
- FS, Telecom, E commerce and Technology were the top 4 sectors in terms of PE exit activity

Budget Backdrop

- The healthy investments and exits scenario indicates that Indian PE/ VC sector has passed an inflection point along its maturity curve
- According to a recent Limited Partners survey conducted by EMPEA, the Emerging Markets Private Equity Association, India is now the most attractive emerging market for PE investments in 2018, climbing over 9 places in the past 4 years
- Long term structural changes in the economy driven by improvement in the ease of doing business (Indian entered top 100 “Ease of Doing Business” raking in 2017), tax and regulatory reforms like GST, RERA, Insolvency and Bankruptcy Code, liberalization in FDI policy, etc have made India an attractive destination for long term capital into the country

02 Key Policy Announcements

Key policy announcements

- Additional measures to be undertaken to strengthen the environment for the growth of Venture Capital Funds and the angel investors and for successful operation of alternative investment funds in India
- Existing guidelines and processes to be reviewed to bring out a coherent and integrated Outward Direct Investment policy
- Separate policy to be evolved for hybrid instruments
- SEBI to consider mandating, beginning with large Corporates, to meet about one-fourth of their financing needs from the bond markets
- Stamp duty regime on financial securities transactions to be reformed in consultation with the States

03 Tax Proposals

Tax rates

- Individual tax slab rates and surcharge rates remain unchanged
- "Education Cess" and "Secondary and Higher Education Cess" aggregating to 3% replaced with "Health and Education Cess" at the rate of 4%

Corporate tax rate

- Reduced corporate tax rate of 25% (effective rate of 29.12%) to apply to domestic companies with total turnover not exceeding INR 250 crores in financial year 2016-17
  - Previously, corporate tax rate of 25% was applicable to companies with total turnover not exceeding INR 50 crores in financial year 2015-16
  - Companies with total turnover exceeding INR 250 crores in financial year 2016-17 to continue to be taxed at 30% (Effective rate at 34.94% due to increase in cess)

Taxation of long-term capital gains

- Currently, capital gains arising on transfer of long-term listed equity shares, units of equity oriented mutual fund and units of business trust on recognised stock exchange is exempt from tax in India subject to payment of securities transaction tax (STT)
- Long-term capital gains (exceeding INR 1 lakh) on aforesaid securities now proposed to be subject to a concessional tax rate of 10% subject to payment of STT, without the benefit of indexation and foreign currency fluctuation
- In respect of such shares or units acquired before 1 February 2018, cost of acquisition shall be deemed to be higher of:
  - Actual cost of acquisition of such asset; and
  - Lower of (i) Fair Market Value (FMV) of such asset; and (ii) Full value of consideration received or accruing as a result of transfer
- FMV shall be the highest price of the shares or units quoted on any recognised exchange on 31 January 2018 or a preceding date where the shares or units are not traded on 31 January 2018

Taxation of long-term capital gains

- What continues?
  - Period of holding remains unchanged
  - STT to apply irrespective of an income-tax being introduced on the gains
  - No change in short-term capital gains tax rate
  - No change in taxability of unlisted shares/ securities
  - Proposed amendment not to impact grandfathering and benefit of transitional rates under Mauritius/ Singapore tax treaty
  - Long-term capital gains earned upto 31 March 2018 continue to be exempt under section 10(38)

Taxation of long-term capital gains - Illustrative Computation

Particulars		Example 1 (INR)		Example 2 (INR)		Example 3* (INR)	
Sale consideration	**A**		200		200		200
Cost of Acquisition (Acquired on 1 January 2017)	**B**		150		150		500
Market Price as on 31 January 2018	**C**		190		100		150
Capital Gains Computation							
Sale consideration	**D**		200		200		200
Less : Cost of Acquisitions - shall be **higher** of (a) and (b)	**E** = Higher of F and G		190		150		500
a) the actual cost of acquisition of such asset (B); and	**F** = B	150		150		500	
b) the **lower** of – (I) Market value as on 31 January 2018 (C); and (II) Sales Consideration (A)	**G** = Lower of C and A	190		100		150	
Net Taxable Capital Gains / (Loss)	**H** = D – E		10		50		(300)
Tax Liability (excluding surcharge and education cess)	**I** = H * 10%		1		5		NIL

*** Applicability of the new provision to an actual loss scenario?**

Comparative snapshot of outcomes

Instrument	Status at the time of acquisition	Status at the time of sale	Sale Platform	Taxability	
				Resident	Non-Resident
Equity Shares	Listed	Listed	On stock exchange	10%	10%
			Off-market	10%(without indexation)/ 20% (with indexation)*	10%*
Equity Shares	Unlisted	Listed	On stock exchange	10%**	10%**
			Off-market	10%(without indexation)/ 20% (with indexation)*	10%*
Equity Shares	Unlisted	Unlisted	IPO	10%**	10%**
Equity Shares	Unlisted	Unlisted	Off-market	10%(without indexation)/ 20% (with indexation)*	10%*
Compulsorily Convertible Preference Shares/ Debentures	Unlisted	Converted to equity shares that are listed	On stock exchange	10%**	10%**

* Under section 112

** Subject to notification similar to that issued in the context of section 10(38) exemption

Widened scope of “business connection”

- Definition of “business connection widened in line with the Modified Permanent Establishment (PE) rule as per Multilateral Instrument
  - Dependent Agent PE to now include activities of an agent that habitually plays a principal role in negotiations leading to conclusion of contracts by the non-resident

- Business connection to cover non-residents having “significant economic presence” in India through digitized businesses and includes:
  - Provision of download of data or software in India
  - Systematic and continuous soliciting of business activities or engaging in interaction with user base in India
- “Revenue” and “Users” threshold to be notified

The above proposals to not impact existing tax treaties unless renegotiated

Expansion of scope of Dependent Agent PE to be evaluated for its impact once MLI becomes effective for India bilateral treaties

Measures to promote start-ups

- Scope of eligible business which is entitled to tax holiday as a start-up now expanded to cover “improvements of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation”

- Benefit extended to entities incorporated before 1 April 2021 as against 1 April 2019 provided earlier

- Turnover limit of INR 25 crores to be seen in any of the seven previous years beginning from the year in which such entity is incorporated as against the period of 1 April 2016 to 31 March 2021, provided earlier

Measures to promote International Financial Service Centre (IFSC)

- Transactions in the following assets entered on or after 1 April 2018, on a recognized stock exchange in IFSC, by a non-resident would not be regarded as a transfer and hence not taxable, provided the consideration is payable in foreign currency:
  - Bond or specified Global Depositary Receipts
  - Rupee denominated bond of an Indian company
  - Derivatives
- Unit located in IFSC, being a non corporate person, would be subject to Alternate Minimum Tax at the rate of 9%

Relief to companies under insolvency resolution process

- Relief from Minimum Alternate tax (MAT)
  - Applicable to companies against whom application for insolvency resolution process has been admitted under Insolvency and Bankruptcy Code, 2016 (IBC)
  - Book profits of such companies for MAT purpose shall now be reduced by aggregate of brought forward loss (excluding depreciation) and unabsorbed depreciation
  - In line with press release by Ministry of Finance dated 6 January 2018
  - This amendment will be effective from the assessment year 2018-19

- Eligibility to carry forward tax losses
  - Change in shareholding of a company pursuant to resolution plan approved under IBC shall now not result in lapse of carried forward business loss of such company
  - This amendment will be effective from the assessment year 2018-19

Taxability of write backs continue to remain a major concern. The amendments do not propose to cover companies under other restructuring schemes of the Reserve Bank of India

Other amendments

Amendments relating to dividend

- Scope of "accumulated profits" widened
  - Accumulated profits (whether capitalised or not) or losses of an amalgamated company to now include accumulated profits (whether capitalised or not) of the amalgamating company as on the date of amalgamation
  - Accumulated profits of the amalgamating company also to be considered for the purpose of deemed dividend
  - This amendment will be effective from the assessment year 2018-19

- Applicability of dividend distribution tax to deemed dividend
  - Loans and advances made by companies to shareholders, which qualify as "dividend", to be liable to dividend distribution tax at rate of 30% (without grossing up)
  - Such dividend income to be exempt in the hands of recipient

Other amendments

Amendment relating to tax neutral transfers

- Transfers of property between a wholly owned subsidiary and its holding company without or for inadequate consideration to now not be taxable in the hands of recipient of the property
- Amendment applicable in relation to transactions made on or after 1 April 2018

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