India Union Budget 2023-24

Potential impact on PE/VC Industry and M&A deals

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Foreword

The Finance Minister, presented the Union Budget 2023 on 1 February 2023, her fifth and the last full budget ahead of the general election next year.

The Budget focused on enhancing opportunity landscape, providing impetus to growth by directed capex on green infra and certain new-age sectors, to have a stronger and stable macro economy. In FM's words, this budget, being the first one of "Amrit Kaal", lays foundation for India@100 i.e. for the next 25 years. With India in the forefront of the changing world economic order, the Budget lays down seven core priority areas complementing each other and act as the "Saptarishis" guiding us forward.

With the target to remain the fastest growing economy, stable policies and continuous improvement in the ease of doing business in India, the FM has laid a foundation for the continuous growth for Indian businesses and encouraging entrepreneurship through start-ups. I believe that the PEs / VCs will stand to gain by investing in the right businesses.

The key proposals of the Budget impacting the PE / VC industry and M&A Deals in India have been summarised in the ensuing pages.

Vivek Gupta
Partner and National Head
M&A and Private Equity Tax,
KPMG in India

Private Equity and IFSC

Policy proposals

- Delegation of power under SEZ Act to IFSCA to be the sole regulatory for IFSC.
- Set up of single window IT system registration and approval from IFSCA, SEZ authorities, GST authorities , RBI, SEBI and IRDAI.
- Acquisition financing to be permitted by IFSC banking units of foreign banks.
- Offshore derivative instruments in IFSC to be recognised as valid contracts.
- No policy changes announced pursuant to PE / VC expert committee report.

Tax proposals

- Angel taxation provisions extended to shares issued to non-residents above tax FMV.
  - Impact on PE / VC investment structures
  - Eligible startups, Cat-I and Cat-II AIFs continue to be out of the scope of angel taxation
- Capital gains arising from transfer / redemption of 'Market linked debentures' taxable as short-term capital gains irrespective of holding period.
- Withdrawal of exemption from TDS on payment of interest on listed debentures to a resident.
- Tax exemption for migration of offshore fund to IFSC extended up to 31 March 2025.
- Clarity on tax pass through for Funds under the new IFSC Fund management regulations.

Expert view – Kalpesh Desai

Extending the angel taxation provisions to non-resident investors would have a material impact on private equity transactions of offshore PE / VC funds. The new requirement will be in addition to the existing set of pricing norms under FEMA and Companies Act and could raise practical challenges in closing deals for offshore PE / VC funds.

Financial Service Sector

Policy proposals

- Financial sector regulators to carry out comprehensive review of existing regulations to simplify and reduce compliance cost.
- KYC process to be simplified adopting a 'risk-based' approach.
- Amendments to be proposed in Banking Regulation Act, the Banking Companies Act and RBI Act to improve bank governance and enhance investors' protection.

Expert view – Kalpesh Desai

It is a welcome move of CBDT, accepting the industry ask to exclude NBFC from the applicability of thin capitalisation provisions, bringing in parity with banks.

Tax proposals

- Notified NBFCs to be exempted from thin capitalisation provisions limiting interest deduction in line with banks.
- Owing to recent re-classification of NBFCs in terms of RBI guidelines, NBFC to be notified for:
  - Interest deduction to borrowers on payment basis
  - Special provision for taxability of interest on bad loans
- Enabling provision allowing tax treaty relief on withholding tax on income distributed by mutual funds to non-residents to be introduced.
- Transfer of physical gold to Electronic Gold receipt and vice versa not to be regarded as transfer and exempt from capital gains tax. Consequential provisions for period of holding/cost of acquisition introduced.

Infrastructure and SWF/PF

Policy proposals

- Capital investment outlay increased by 33% to INR 10 lakh crore, which is 3.3% of GDP.
- 50 additional airports, heliports, etc will be revived for improving regional air connectivity.
- INR 35,000 crore allocated towards Energy Transition, Net Zero objectives and energy security.
- India's National Green Hydrogen Mission initiative with the aim of annual production of 5 MMT by 2030.
- Battery Energy Storage with capacity of 4,000 MWH will be supported with Viability Gap Funding.
- Detailed framework for Pumped Storage Projects will also be formulated.
- 500 new ‘waste to wealth’ plants under GOBARdhan scheme will be established with total investment of INR 10,000 crore.
- Harmonised list of infrastructure to be re-looked by the expert committee.
- Fund with an annual allocation of INR 10,000 crore will provide impetus to the development of urban infrastructure across cities.
- Inter-state transmission system for evacuation and grid integration of 13GW renewable energy from Ladakh will be constructed with investment of INR 20,700 crore including central support of INR 8,300 crore.

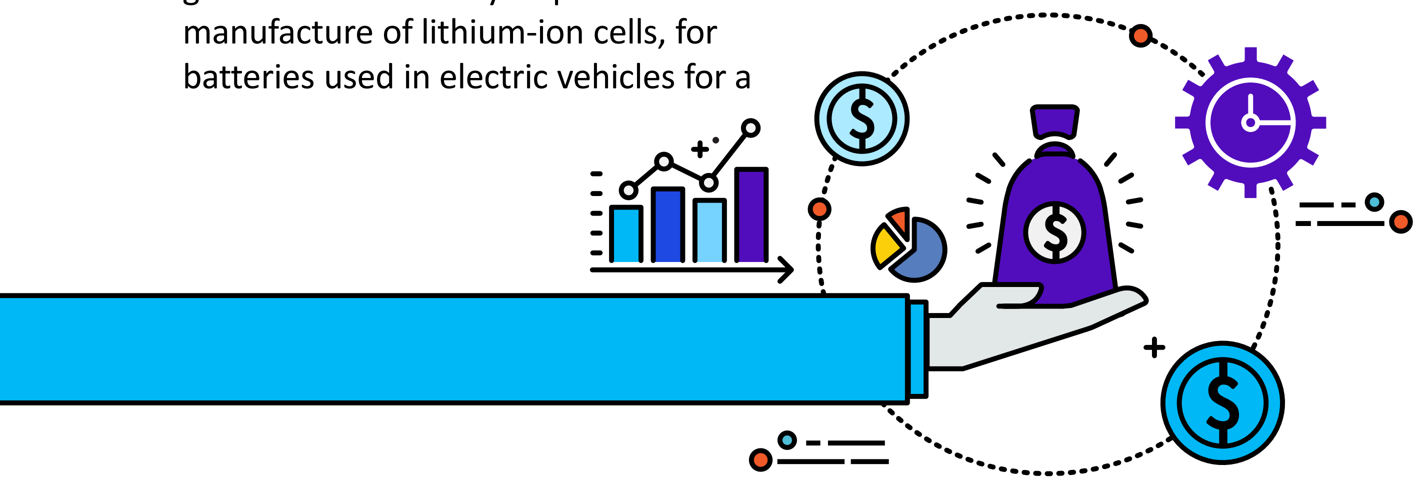
Infrastructure and SWF/PF

Tax proposals

- Repayment of capital by business trust to unitholders proposed to be taxable as income from other sources.
  - Cost of acquisition available as a deduction (to the extent of distribution) in case of redemption of units by a business trust.
- Enabling provisions introduced in the law providing the ability to obtain lower withholding certificate in case of distribution of income by business trust.
- Benefit of concessional customs duty under Project Import Regulations on import of goods required for setting up. 'Solar power project/plant' is proposed to be removed.
- Customs duty exemption is provided for the import of specified capital goods and machinery required for the manufacture of lithium-ion cells, for batteries used in electric vehicles for a year.
- Custom duty exemption for solar tempered glass, used in solar cell or solar module.

Expert view – Nandita Tripathi

Overall large part of the capex has been pushed to give solidarity to the physical infrastructure of the country. Energy transition has been a big theme in the budget clearly reflective of country's roadmap to achieve net zero target



Real Estate Sector

Policy proposals

- Increase in outlay by 66% to INR 79,000 crore for PM Awas Yojana is expected to boost the demand for affordable housing.

Tax proposals

- Restriction on double deduction of interest paid on capital borrowed for house property
  - Currently, the interest paid is being allowed as a deduction in computing taxable income from house property. Taxpayers may have also claimed a deduction for such interest, at the time of transfer of house property, as part of cost of acquisition/improvement
  - Proposal is to exclude such interest claimed as deduction under house property, from being a part of cost of acquisition/improvement on transfer of such property
- Super premium taxation which was bought in to deal with the menace of unaccounted money, was so far restricted to unjustifiable share premium received by companies from resident investors. Now it is proposed to extend the scope of same to cover even non-resident investors.
- Maximum deduction being claimed against long term capital gains through reinvestment in new residential property capped at INR 100 million.
- Clarificatory amendment has been proposed with regard to the consideration received under development agreement to not only be limited to cash, rather all forms of monetary consideration.

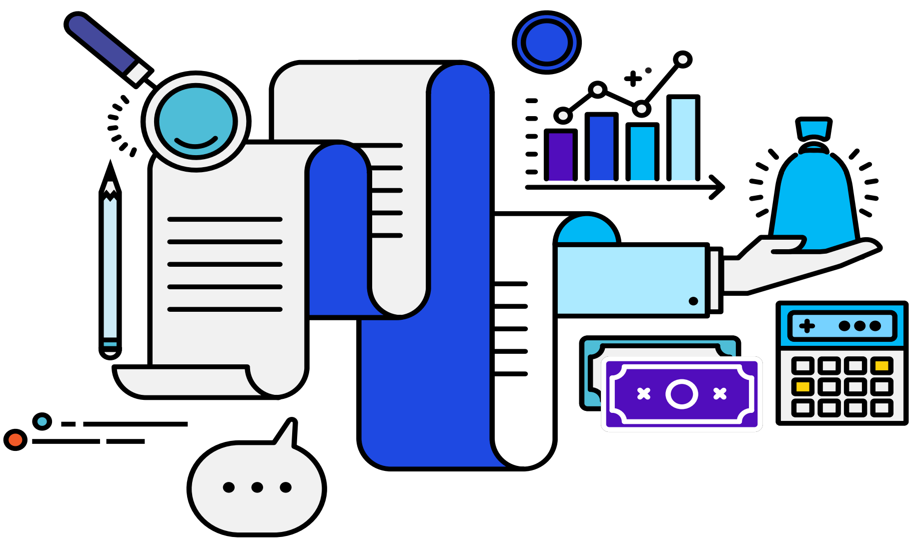
Expert view – Kalpesh Maroo

While being directionally right on the policy front, the budget largely maintains status-quo on the tax front with many of the key asks of the real estate industry remaining unaddressed. Lack of an implementation roadmap for the DESH Bill, non-extension of the beneficial tax rate regime on non-resident bonds, no incremental incentives on affordable housing and interest rate deduction (for home buyers) are the key misses!

Technology Sector

Policy proposals

- Agriculture Accelerator Fund to be set up for encouraging innovative start-ups in rural areas and provide cost-effective solutions and modern technologies to farmers to boost output and profitability.
- Digi locker – To be set up for use by MSMEs, business enterprises and charitable trusts for securely sharing documents online. Scope of documents available in the Digilocker for individuals to be expanded.
- Introduction of National Data Governance Policy to enable access to anonymised data for research by start-ups and academia.
- Simplification of KYC process by adopting a ‘risk-based’ instead of ‘one size fits all’ approach.
- Three specialised AI centres are proposed to be created. India to embark on a vision “Make AI in India and Make AI work for India”.
- ‘Pradhan Mantri Kaushal Vikas Yojana 4.0’ - Training youth in industry aligned courses and new age courses (coding, AI, robotics, mechatronics, IOT, etc.).



Technology Sector

Tax proposals

- Eligible startups were permitted to carry forward their losses even in the event of a substantial change in shareholding subject to certain conditions. This relaxation was however applicable for losses incurred during 7 years from date of its incorporation, which has now been extended to 10 years. The maximum time limit for carry forward of business losses i.e., 8 years remains unchanged.
- Tax holiday benefit was available for 'Eligible start-ups' incorporated before 1 April 2023, which is now proposed to be extended till 31 March 2024.
- For online gaming, users will have to pay tax at the rate of 30 percent (plus applicable surcharge and cess) on their net winnings. The computation mechanism for net winnings is to be prescribed. Taxes are to be withheld on withdrawal of such net winnings or net winnings remaining in the user account at the end of the financial year.

Expert view – Kalpesh Maroo

Technology driven interventions continue to remain on the forefront of Government's initiatives on ease of doing business and are expected to be a significant growth driver for the domestic IT services market.

New tech space also received a fare share of attention and the proposal for National Data Governance Policy and unified business identification through PAN will spur the next wave of innovation and add to India's existing impressive digital public infrastructure particularly in the fintech space.

M&A and General Tax

Tax proposals

- Cost of acquisition and improvement of self-generated intangibles to be 'Nil'. However, acquired intangibles to remain eligible for deduction.
- Accumulated loss and unabsorbed depreciation of banking company in case of amalgamation subsequent to strategic disinvestment permitted to be carried forward provided such amalgamation takes place within 5 years of strategic disinvestment.
- Limit of INR 10 crore to be applied for computing exemption of long-term capital gains on reinvestment of specified amount in a residential house property.
- Cost of acquisition or cost of improvement to not include interest payable on borrowed capital for acquiring, renewing or reconstructing a property claimed under section 24 or Chapter VIA.
- Framework laid down to enable assessment / re-assessment by tax authorities where modified income-tax return is filed pursuant to a business reorganization.
- Deduction of sum payable by a taxpayer to a micro or small enterprise beyond the time limit specified under Micro, Small, and Medium Enterprises Development Act, 2006 (MSME Act) to be allowed on a payment basis.

Expert view – Nilesh Mody

Rationalising tax reporting and assessment rules in case of business reorganisation is a welcome move and will reduce tax compliance related complications for Indian companies undertaking re-organisation.

KPMG in India contacts

Nitish Poddar
Partner and India Leader, PE
T: +91 124 334 5091
E: npoddar@kpmg.com

Vivek Gupta
Partner & National head, M&A and PE Tax
T: +91 124 307 4025
E: vivekg1@kpmg.com

Kalpesh Maroo
Partner & Head of Tax (South), M&A and PE Tax
T: +91 80683 35000
E: kalpeshmaroo@kpmg.com

Nandita Tripathi
Partner, India Tax Leader, ENR Sector
T: +91 124 307 4036
E: ntripathi@kpmg.com

Kalpesh Desai
Partner, Deal Advisory – M&A and PE Tax
T: +91 22 3090 2300
E: kalpeshdesai@kpmg.com

Nilesh Mody
Partner, Deal Advisory – M&A and PE Tax
T: +91 22 6134 9200
E: nileshmody@kpmg.com

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