

# India Union Budget 2023-24

## Point of view

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## Private Equity

## Key announcements for the sector

- Deemed income-tax on allotment of shares, on share premium in excess of fair market value (as per tax valuation rules), is proposed to be made applicable on fund-raises from non-resident investors starting 1 April 2023. As of now, this deemed income-tax under section 56(2)(viib) in the hands of Indian investee company (also known as “Angel tax”) is applicable only on fund-raise from Indian residents.
- Bolstering the start-up ecosystem:
  - Extension of ‘start-up’ tax-holiday to include eligible start-ups incorporated by 31 March 2024
  - Period of eligibility for carry forward of tax loss of an eligible start-up without the restriction on change in shareholding of more than 51% extended from 7 years to 10 years from the year of incorporation.
- Distributions by REIT / InvIT to unitholders of amounts received from SPVs as repayment of debt, is proposed to be taxed in hands of the unitholders as ‘Income from Other Sources’. If such distribution is made towards redemption of units, the cost of acquisition of such units (to the extent that the cost does not exceed the sum received by the unitholder), would be available as a deduction.
- Continuing measures for increasing attractiveness of International Financial Services Centre (IFSC)/ GIFT City:
  - Single window clearance and removal of dual regulatory oversight from SEZ authority
  - Time period for tax exemption on relocation of offshore fund to resultant fund in IFSC extended to 31 March 2025
  - Income distributed by offshore banking unit (IBU) in IFSC to non-resident on offshore derivative instruments to be exempt from income-tax
  - Finance Minister’s budget speech also mentions permitting of acquisition financing by IFSC banking units of foreign banks.
- Enabling provisions for sovereign wealth funds and pension funds to apply for no-withholding tax certificate for income received from REIT / InvIT
- Clarification provided that the cost of acquisition and improvement for all self-generated intangibles to be considered as nil
- Income on sale or redemption of ‘Market Linked Debentures’, (i.e., hybrid debt securities with underlying principal component in the form of debt and returns linked to market performance) to be taxed as short-term capital gains
- Scope of taxation on benefit / perquisite widened to include receipt in cash or in kind or partly in cash or partly in kind
- Cap on long capital gains exemption to maximum ceiling of INR10 crore on reinvestment in a residential house property

- Amendment in the definition of 'strategic disinvestment' by Government or public sector company for the purpose of carry forward and set-off of accumulated tax losses and unabsorbed tax depreciation. Continuing tax benefits in case of amalgamation of banking company with another banking institution or company subsequent to a strategic disinvestment, if such amalgamation takes place within 5 years of the strategic disinvestment
- Enabling provisions introduced to allow tax officer to pass modified assessment/reassessment order considering modified return in case of business re-organisations under Section 170A of the Act.

## Implications for the sector

Focus of the Finance Bill, 2023 primarily seemed to be on leaving more disposable income in hands of middle-class group, promoting start-ups and IFSC operations. Few of the key asks of the industry which have been positively considered by are as follows:

- Extension of tax holiday to eligible start-ups set up by 31 March 2024 and providing easy exit to founders of start-ups by extending the period of carry-forward of losses for up to 10 years from year of incorporation, even after change in shareholding of more than 51%
- Providing various tax incentives for units set up in IFSC including tax-neutrality to holder in AIFs relocated from outside India to IFSC and exemption to Offshore Derivative Instruments holders on distribution of income by IFSC banking unit.

However, certain proposals may have unintended consequences and may require further evaluation:

- Applicability of deemed income-tax for Indian companies on fund-raises from non-residents could have wide ramifications on deal structures, including already concluded tranche arrangements, ratchet etc
- Bringing the capital repayments by the REIT/InvIT to unitholders under the tax net at a higher rate would impact investment metrics of REIT/InvIT structure. It also ignites the debate on taxability of such receipts as capital receipts vis-à-vis other income under the Act and the tax treaty. The proposed characterisation of capital repayment amounts as 'income from other sources' could potentially raise questions on eligibility for tax exemption for sovereign funds and pension funds on these distributions.

Some of the key wishlist points which are yet to be addressed include:

- Rationalisation and simplification of capital gains taxation by bringing in parity in tax rates
- Allowing carry forward of losses in case of amalgamations of service sector entities
- Reducing tax reassessment period from existing 10 years to lower period of 3-5 years to provide easier exit conditions to investors
- Extending beneficial tax rate of 5% under specified circumstances to non-residents/ FPIs on interest income
- Clarity on extension of tax exemptions on investments made by eligible sovereign wealth funds and pension funds after 31 March 2024
- Advancement of the measures identified by the Economic Survey to encourage 'reverse flipping'.

Further, the Finance Ministry had constituted an expert committee in line with announcement made in previous budget to examine and suggest appropriate measures to address regulatory issues to scale up investments by venture capital (VC) and private equity (PE). The industry is keenly watching for the recommendations / suggestions to be adopted, which are expected to act as a catalyst to accelerate the growth of alternative capital in the VC/PE industry.

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