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India Beckons Foreign Investors With 2022 Budget Measures

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In this article, Khanna reviews the tax changes in India's 2022-2023 budget, focusing on how they will affect foreign investors and multinational enterprises doing business in India.

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India's 2022 budget, announced February 1, is based on the themes of digitalization, infrastructure, and clean energy. The intention behind its proposals is to garner more investments and widen the tax base to meet India's $5 trillion economy goal by 2025.

The budget has proposed nearly 200 changes. This article examines the key proposals that affect foreign investors and multinational enterprises doing business in India.

GIFT City

The Gujarat International Finance Tec-City (GIFT City) is India's first and only international financial services center (IFSC). Situated in Gandhinagar, Gujarat, about 12 miles from Ahmedabad Airport, it is a greenfield smart city with a fully integrated, best-in-class infrastructure, connectivity, people, technology, and legal framework. It has adopted the best practices of financial services centers across the globe.

The project includes office spaces, residential apartments, schools, hospitals, hotels, and various retail and recreational facilities. It is a true "walk to work" city, consisting of a multi-service special economic zone and an exclusive domestic area.

GIFT City is unique in that both branches of the Indian government, central and state, have announced several tax and fiscal incentives, subsidies, and exemptions to attract businesses to set up operations there.

The 2022 budget includes four announcements for GIFT City: (1) the development of an international arbitration center for faster and smoother cross-border dispute resolution; (2) incentives to attract foreign universities; (3) tax exemptions for ship leasing and financing; and (4) tax exemptions for offshore fund management and offshore banking at the IFSC.

The GIFT City plan is expected to attract some of the foreign universities and institutions that have been exploring opportunities in the country for the last several years but stayed away because of an unfavorable regulatory environment. In her recent budget speech, Finance Minister Nirmala Sitharaman confirmed that, under the new budget plan, "world-class foreign universities and institutions" will be allowed in GIFT City to offer courses in financial management, financial technology, science, technology, engineering, and mathematics "free from domestic regulations, except those imposed by the [IFSC Authority] to facilitate the availability of high-end human resources for financial services and technology."

The following is an illustrative list of tax incentives and subsidies offered under the proposal:

- a 100 percent corporate tax exemption for 10 consecutive years (out of a block of 15 years) from the date of approval from the regulator regarding income from business carried on in an IFSC;
- a reduction in the minimum alternate tax from 18.5 percent to 9 percent (companies in

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an IFSC opting for a new tax regime are exempt from minimum alternative tax provisions);
- exemptions from some of the compliance requirements of the 2013 Companies Act, including corporate social responsibility provisions or five years from commencement;
- no limits on managerial remuneration and no requirement to set up audit, nominations, or remuneration committees;
- a capital subsidy from the state government set at 25 percent of capital expenditure for a one-time purchase of computers, networking, and related hardware (subject to a ceiling of INR 10 million);
- a 100 percent reimbursement of paid stamp duty and registration fees;
- a 100 percent reimbursement of the electricity duty and the INR 1 subsidy on power tariff for five years;
- reimbursement of the provident fund contribution by an employer (100 percent for female employees and 75 percent for male employees); and
- a lease rental subsidy (depending upon the number of employees).

The additional announcements in the 2022 budget will further contribute to making GIFT City an attractive business hub for foreign companies willing to do business in India.

Financial Incentives

An IFSC caters to customers outside the jurisdiction of the domestic economy. Such centers deal with the flow of finance, financial products, and services across the borders. The IFSC in GIFT City seeks to bring back to Indian shores the types of financial services transactions that are currently performed outside of the country by overseas financial institutions, branches, and subsidiaries of Indian financial institutions.

Various incentives have been provided to units (companies LLPs, funds, branches, and so forth) in IFSCs in the past. To further promote operating from IFSCs, a few additional incentives have been proposed, including the following ones, which propose that some incomes should be considered exempt in the hands of nonresidents:

- income earned from the transfer of offshore derivative instruments or over-the-counter derivatives entered into with an offshore banking unit of an IFSC;
- income from royalty or interest from the leasing of a ship, paid by a unit of an IFSC if the unit commences operations on or before March 31, 2024 (the definition of the term "ship" has also been inserted under the explanation to this section); and
- income from a portfolio of securities or financial products or funds, managed or administered by any portfolio manager on behalf of the nonresident, in an account maintained with an offshore banking unit to the extent income accrues outside India.

Tax Regime for Virtual Digital Assets

Currently, there are no regulations or bans concerning the use of cryptocurrencies in India. Also, cryptocurrency is not considered legal tender in the country.

In 2018 the Reserve Bank of India banned banks and financial institutions from transacting in virtual currencies. However, in 2020, a landmark Supreme Court decision[1] held the ban to be unconstitutional, reversing the prohibition and allowing the crypto exchanges to reopen.

However, there is still no clarity on the regulatory fate or the legality of virtual currencies in India, and it is widely anticipated that the government will enact detailed law regarding the regulation of cryptocurrencies.

Although the expected legislative action has not occurred, the 2022 budget clarified the government's position regarding the taxability of gains arising from cryptocurrencies, bringing them within the purview of income tax compliance structure.

Sitharaman ended the ambiguity over the taxation of gains from investments in cryptocurrency, labeling them as "digital assets" and not currency. The budget has proposed taxing "virtual assets." There are proposals to define the term "virtual assets" and to determine their

[1] *Internet and Mobile Association of India v. RBI*, LSI-128-SC-2020(NDEL) (2020).

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taxability, including deductions and losses, and the applicability of gift and withholding tax.

The proposal provides an exhaustive and broad definition of virtual digital assets. One criterion defines the term broadly as any information or code or number or token generated through cryptographic means *or otherwise*, which can be transferred, stored, or traded electronically.

The budget proposes a special tax rate of 30 percent on income or gains from the transfer of any virtual digital asset, irrespective of the period of holding. Transfer includes a sale, exchange, or relinquishment of an asset or the extinguishment of any rights held therein.

No deduction will be allowed for expenses incurred (except for the cost of acquisition). Also, losses on such investments will not be allowed to offset any other income or gain from any other class of assets. Moreover, losses are not allowed to be carried forward to future years.

It has been proposed that gifts of virtual assets will be taxed in the hands of the recipient. In India, not all gifts are taxable. For example, there is an exemption from tax on gifts from relatives. The same exemptions will apply to the receipt of virtual assets.

Another relevant aspect of the gift tax law is how to value the gift. Section 56(2)(x) of the Indian Income Tax Act, 1961, is an antiabuse provision. It deems as income any sum of money, immovable property, or any property (other than an immovable property) that is received by a recipient: (a) without consideration and with the fair market value of the property exceeding INR 50,000 (approximately $660); or (b) for a consideration that is less than the aggregate FMV of the property by an amount exceeding INR 50,000.

The valuation of virtual digital assets for the purpose of arriving at income chargeable to tax in the hands of a recipient who has received them as a gift will be challenging — given their volatile nature (unless valuation guidelines are prescribed by the government).

It is common in the crypto world for crypto projects to "airdrop" their tokens (that is, provide free tokens to encourage adoption). Similarly, promotional tokens might be issued for marketing purposes. It appears that the use of cryptocurrency in this manner will be taxable in the hands of the recipient if the value exceeds INR 50,000 (thus triggering the valuation mechanism of section 56(2)(x)). Moreover, it may be an issue if those tokens have an independent market value.

Further, 1 percent withholding tax is to be deducted by the purchaser of cryptocurrencies from payments made to the seller if the aggregate value of the transaction exceeds INR 10,000 in a financial year. The rate is INR 50,000 for small individual taxpayers having no business or professional income or business turnover not exceeding INR 10 million and professional receipts not exceeding INR 5 million.

The withholding tax compliance rules are introduced to keep track of transactions regarding the sale or purchase of cryptocurrencies. The onus for compliance is on the buyer. The withholding tax provisions are also applicable to nonresidents if they are making a payment to a seller of cryptocurrencies who is an Indian resident.

Digital Currency Introduction

Sitharaman also announced that India's central bank, the Reserve Bank of India, will launch a digital version of the rupee in the next financial year. Sitharaman mentioned that it will be introduced "using blockchain and other technologies." She also said the introduction of a central bank digital currency will give "a big boost to the digital economy" and that "digital currency will also lead to a more efficient and cheaper currency management system."

The Reserve Bank of India will introduce the digital rupee in financial year 2022-2023. The introduction of a central bank digital currency will boost the digital economy and lay down a solid plan for a public digital currency. However, ambiguity still exists regarding the government's position on private cryptocurrencies being traded in the market. There is an urgent need for the government to provide clarity to this segment and to devise an appropriate regulatory framework. International investors need to keep a close tab on the government's action and policy decisions regarding this issue.

Introducing a digital rupee based on blockchain technology and bringing virtual assets like cryptocurrencies and non-fungible tokens under the tax system seem to be ambitious steps,

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taking place even before the government's legal recognition of cryptocurrency.

The government has indicated that it is keeping a close tab on the evolving framework of cryptocurrency around the world and wants to ensure that they develop the most suitable framework for their economy. Therefore, they are not closing their minds to any possibilities.

The government's endeavor appears to be in tandem with a global framework that is still evolving. In the meantime, it will need to take steps to ensure consumer protection and its right to tax cryptocurrency transactions and assets.

Earlier this year, at the Summit for Democracy hosted by U.S. President Biden, Indian Prime Minister Narendra Modi called for united efforts to shape the global norms for social media and cryptocurrencies so that they can be used to "empower democracy and not to undermine" it.

Special Economic Zones Act Replacement

The Special Economic Zones Act will be replaced with new legislation that will empower states to become partners in developing enterprise and service hubs. The legislation will cover all large industrial enclaves (new and existing) and will include incentives to efficiently use infrastructure and enhance export competitiveness.

The new legislation will focus on not only exports but it will also include incentives for industrial and service sector development. Thus, special economic zones will be gradually converted into "plug-and-play" infrastructure that can be used for both the export and domestic industries. The updated legislation on special economic zones is expected to be introduced in four to six months.

Battery-Swapping Policy

Acknowledging the constraint of space in urban areas for setting up charging stations for electric vehicles, the finance minister proposed to introduce a battery-swapping policy and frame inter-operability standards. Sitharaman said companies will be encouraged to develop sustainable and innovative business models for batteries or energy as a service that will improve efficiency in the electric vehicle ecosystem. This is designed to encourage investment in this segment, and may be especially attractive to investors, considering that India already has an abundance of low-cost labor available for the manufacturing.

Many investors have already shown interest in setting up their operations in India. Elon Musk, CEO of Tesla, the market leader in the electric vehicle automobile segment globally, said he is keen to establish operations in India. However, some obstacles, including high import duties, land policy of states, and so forth have yet to be resolved.

Tax Rates

There has been no change in the corporate tax rate — it remains at 25.17 percent. However, there is an option of a concessional tax rate of 17.16 percent for a new domestic manufacturing company (contingent upon it not availing itself of any of the specified incentives or deductions and fulfilling other specified conditions). To provide relief to domestic companies for delays in manufacturing or production resulting from the prolonged effects of the COVID-19 pandemic, there is a proposal to extend the last date of the commencement of manufacturing or production by one year, from March 31, 2023, to March 31, 2024.

Corporate tax rates for foreign companies and branches of foreign banks remain at 43.68 percent, although it was highly anticipated that the government might reduce that rate or even align it with the rate for domestic players (25.17 percent).

Currently, if dividend income is received by an Indian company from a foreign company in which the Indian company holds 26 percent or more of the nominal value of equity shares (specified foreign company), a concessional tax rate of 15 percent (excluding surcharge and cess) is applicable in the hands of the Indian company on that dividend income. It is proposed that, effective in fiscal years 2022-2023, the concessional rate of taxation for an Indian company on dividends received from a specified foreign company will not be applicable, but the dividends will be taxable under the regular tax rates.

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Ease of Doing Business 2.0

The 2022 budget proposes to introduce trust-based governance to facilitate the ease of doing business in India. The government has announced that it will launch the next phase, version 2.0, of the "Ease of Doing Business" regulations. In the past few years, these regulations have resulted in the reduction of around 25,000 statutory and operational compliance requirements and the repeal of 1,486 laws.

Under the revised framework, the central government works closely with states to design a trust-based model of governance — using such features as the digitalization of manual processes; the integration of central and state systems through shared IT bridges; a single, unified clearance mechanism; and the standardization of processes regarding compliance.

Cross-Border Insolvency and Bankruptcy

The budget aims for the faster resolution of bankruptcy filings by paving the way for amendments to the Insolvency and Bankruptcy Code, with the goals of making cross-border deals easier and speeding up the voluntary unwinding of defaulted borrowers.

What the Budget Missed

We witnessed a momentous event last year when the G-20 (including India, a founding member) endorsed the landmark agreement of the OECD and G-20 inclusive framework on base erosion and profit shifting to create a global minimum corporate tax rate of at least 15 percent on multinational companies regardless of where they are based or where their sales are made. One hundred and thirty seven nations have consented to the proposed global minimum tax.

Under the agreement, which represents the consensus of G-20, EU, and OECD nations, no new digital services taxes or similar measures will be introduced, and existing ones will be repealed. India has mentioned its intention to withdraw its equalization levy once the global tax reform is implemented.

Conclusion

The broad response to the budget is that it furthers the vision and roadmap laid down by the Modi government since it first came into power in 2014.

It is pragmatic, with an emphasis on social infrastructure, climate action, and digitalization. It aims to empower India's start-up ecosystem and focuses on foreign investment. Moreover, it gives clarity regarding the taxation of virtual digital assets, an important part of the crypto ecosystem.

Although it missed an opportunity to address some key issues, overall it is an effective budget proposal, especially in this time of unrivaled economic stress.

The thrust of the budget is trust-based governance and the digitalization of the Indian economy. It moves India further into its vision of improving the quality of the lives of its 1.3 billion citizens by focusing on education, infrastructure, digitalization, and the global community. It gives a bold roadmap for improving the ease of doing business in India, reducing litigation, and increasing efficient dispute resolution. The budget will help India to be digital and inclusive, to sustain development, build infrastructure, and boost economic growth. ■

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