# Union Budget proposals unsettle foreign investors

*By Sawant Singh and Davis Kanjamala, Phoenix Legal*

PHOENIX LEGAL

**New Delhi**
Second Floor,
254, Okhla Industrial Estate,
Phase III, New Delhi-110020
India
Tel +91 11 4983 0000
Fax: +91 11 4983 0099
Email: delhi@phoenixlegal.in

**Mumbai**
First Floor, CS-242,
Mathuradas Mill Compound,
NM Joshi Marg, Lower Parel
Mumbai - 400 013, India
Tel: +91 22 4340 8500
Fax: +91 22 4340 8501
Email: mumbai@phoenixlegal.in

The 2012-13 Union Budget presented by India's finance minister, Pranab Mukherjee, was eagerly anticipated by the global investment community as an opportunity for the government to shake off negative perceptions of policy paralysis by outlining a definitive road map signalling its commitment to sustained growth and creation of a conducive investment climate. This column outlines key budget proposals of interest to foreign stakeholders in the Indian economy.

## Foreign investment

In his address, the minister stated that the government was seeking to establish a widespread consensus in favour of permitting foreign investment in multi-brand retail up to 51%. Previously, the decision to allow such investment had to be hastily withdrawn in the wake of strident protests following its announcement.

Foreign investors, which could add significant value to the domestic setup in terms of technology transfer and management policies, have long awaited the chance to participate in India's retail sector, which is among the fastest growing markets in the world.

The minister also announced that the government was mulling whether to allow foreign airlines to acquire up to 49% of the equity of domestic air transport companies. This could pave the way for a series of mergers and acquisitions in the ninth-largest market in the world.

Cash-strapped domestic operators would welcome the move, which would permit them to raise external commercial borrowings (ECBs) of up to US$1 billion. The International Air Transport Association estimates that the sector will require funding of around US$140 billion in the next 20 years to meet predicted demand.

The decision to allow qualified foreign investors to participate in the Indian corporate bond market, a year after they were granted permission to directly purchase mutual fund units, is a significant move that might have several positive long-term ramifications. However, analysts have reacted cautiously in the absence of fine print, which is expected to be released by the Reserve Bank of India in the course of the year.

## Infrastructure

The budget proposes investment to the tune of ₹50,000 billion (US$1,000 billion) over the 12th Five Year Plan (2012-2017) to comprehensively redress the lack of adequate infrastructure. Of this amount, half is sought to be raised from the private sector, to which end the Indian government had established an Infrastructure Debt Fund with an initial size of ₹80 billion to tap overseas funding.

Several proposals expanding the ambit of ECBs have also been made, such as part-financing rupee debt of existing power projects, capital expenditure on toll systems for roads and highways, and low-cost housing projects in major towns and cities. An incentive of reduced withholding tax of 5% (as compared to 20% ordinarily) is being offered for a period of three years to attract ECBs in several crucial infrastructure sectors, such as power, airlines, dams, roads and bridges.

Further, in his address, the finance minister announced the approval of a harmonized master list, issued earlier in a press release by the Cabinet Committee on Infrastructure, with a view to putting in place a uniform definition of "infrastructure", thus removing the ambiguity caused by the same nomenclature imparting different meanings.

## Taxation

The finance minister gave a heads-up on the status of replacing India's antiquated tax laws by more simplified and concise statutes, namely a direct tax code and a statute to govern the goods and services tax. Both are expected to be rolled out in the near future.

Less welcome has been the government's decision to introduce general anti-avoidance rules (GAAR), controversial because of the vast discretionary powers they would give to the Income Tax Department in declaring otherwise permissible arrangements to be made for the express purpose of avoidance of tax and therefore illegal. While the government has given several assurances that due heed will be paid to concerns of investors, in the absence of draft rules, there is widespread uncertainty in the global investment community.

Another shocking move has been the proposal to retrospectively amend the existing law to tax offshore share transfers of foreign companies which involve Indian assets or control of an Indian company. Coming in the aftermath of a five-year tax litigation with Vodafone, which was ultimately decided in favour of the company by the Indian Supreme Court, this is an unprecedented low which would immensely harm India's image as an investor-friendly country.

Overall, the reaction to the 2012-13 Union Budget proposals has been muted, with the absence of bold reforms, the introduction of GAAR and retrospective amendment to tax laws coming in for scathing criticism from all quarters. All eyes are now trained on parliament, which will consider the proposals during the last week of April.

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*Sawant Singh is a partner and Davis Kanjamala is an associate at the Mumbai office of Phoenix Legal.*