

Enriching flow of global capital -Reimagining Tax and Regulatory Regime



Bhavna Doshi
Partner
BDA LLP

Winds of change in geo-political arena are steering rethink of strategies across economies to attract global investments in businesses and capital markets. India is no exception and like any other economy, needs such capital flows, an essential infusion to the lifeblood of any economy. And, it is advantage India, a large democracy, with its huge unexploited potential and growth rate among the highest in the world, to be one of the most attractive destination for investors,

domestic and from across borders, for capital investment in businesses as also capital markets.

Initiatives by India in this direction have demonstrated this amply be, they the liberalisation of 1992 or introducing enhanced and simplified routes for inflow of Foreign Direct Investment (FDI) to Foreign Portfolio Investment (FPI) to creating a virtual foreign enclave in Gift City or schemes like Special Economic Zones, Production Linked Incentives (PLI) directing investment in identified, productive areas. Many initiatives implemented in recent times with special focus on innovation, digitisation and other areas too have played a significant role in India weathering, comparatively efficiently and effectively, global storms from global financial slowdown of 2008 to Covid led crisis of 2020 and treading faster on the path of development. India, like other global economies, is currently navigating the global geo-political crisis and adapting its policy initiatives to weather that storm too with finesse and alacrity. In terms of data, decade of 2014-2024 saw FDI inflow growing from USD 200 billion in preceding decade to USD 500 billion.

While these initiatives are directed at attracting and retaining capital into India, enhancing manufacturing and job opportunities and so on and place India on the path of becoming developed global leader by 2047, the flow of FDI and FPI will have to bear the brunt of global geo-political events, changing regimes and policies with each country vying for global capital and global market for its goods and services amid global economic slowdown.

Amidst this, to my mind, some bold and reimagined initiatives in tax and regulatory regime could support, strengthen and deepen the impact of India's initiatives.

Reimagined and bold tax and regulatory initiatives and reforms

India's taxation rates, corporate and personal, set considering various factors from level of income, economic development and others, offer a fairly favourable tax regime. Rates of taxation of income are set at a reasonable level. Wealth tax is not levied albeit on cost-benefit considerations; cost of collection versus revenue

generation and balancing it with negative impact on wealth creation. Inheritance tax and gift tax are also not levied. There is sort of reverse gift tax charge through income tax law whereby donee is charged income tax primarily, to safeguard against misuse of no gift tax regime.

This regime ought to make India, with its several other advantages, a most attractive, first choice of investment and wealth holding structures or even residence for high and uber-high net worth (collectively, HNIs) individuals as also highly talented individuals and families. Instead, we have and are witnessing brain drain and a movement (though, not an exodus) of HNIs leaving the country. While such movement could be attributed to various factors, some of it can be mitigated by bold and innovative tax and regulatory initiatives and reforms. This may even act as a booster to attract global HNIs to reside in India. Needless to emphasise that such movement has huge over all benefits leading to spiralling impact on overall economic growth and development.

One such initiative/reform to attract HNIs, not only NRIs but, foreign citizens to India could be a regime of **"virtual"/ "deemed" tax non-residency**.

Most countries follow the basic principle of taxation of not taxing a person identified as non-resident in the country, as per the country's tax rules, in respect of income earned or received outside the country and if that is so taxed, such tax is sought to be relieved in terms of double tax avoidance provisions and agreements. India also follows the same principle and a person not resident in India, is not charged to tax in India on income earned or received outside India.

A regime of virtual, deemed non-residency seeks to achieve similar tax impact for a person who may become resident in India. Such a regime could be offered to HNIs making specified investment in establishing and operating, as per global best standards, infrastructure in identified areas say, education and tourism. Thus, such an individual, even if he/she stays in India for a period of more than 60/90/120/182 days, in a year, would not be charged to tax on global income and will pay tax only on income accruing or received in India. Such a regime could bring in multiple benefits. Revenue from new investment in India would generate additional tax revenue, revenue earned or received by individuals in India would also generate additional tax revenue. World class education would attract global talent and mitigate Indian talent moving out of country. World class tourism facilities would attract domestic and global tourists meeting unmet demand and development needs of specified destinations with all its incidental benefits like growing employment opportunities for locals, handicrafts trade, and so on ultimately leading to higher standard of living for people and thereby enhancing the happiness quotient!

This initiative will bear quick fruits at this point of time when some countries have changed their tax regimes which is causing HNIs to leave such developed countries and move to other countries offering beneficial tax regimes. Case in example is the domicile policy of UK which

had enabled UK to achieve almost similar advantages. However, recently, they have, in their own set up and current challenges, done away with this policy leaving only a small window of four years under the new residence based rules. This has resulted in comparatively large scale relocation of HNIs from UK. India with infrastructure, is moving faster to facilitate ease of doing business and its rich quality of life can attract these people, who are seeking relocation, through a policy for granting virtual non-resident status, equivalent to the non- domicile status granted in the past by UK.

Such a special virtual/deemed non-residency is achievable bringing in intended benefits with dynamic and progressive approach, reposing trust and positive attitude in implementation and overhaul of regulatory regime with speedier appropriate clearances, monitoring, adherence to high standards of safety and security, education, training and so on. Such an initiative could achieve unprecedented success especially, in tourism sector whatever be the interest of the tourist, history, heritage, religious, spiritual, adventure, wild life, film making and so on. Key to success, as always, is “Mind set change”. Our culture, tradition and values and desire to succeed with ethics will do the rest, lead the way!

A reform in the form of “virtual or deemed non-tax residency” is not completely new to us; a sort of similar regime already exists for business and industry where, with a view to address the challenge of businesses relocating outside India, we have established enclaves (SEZs including Gift City, the SEZ for the finance industry) where entities can enjoy the same benefits as they would if they were located in a foreign country in terms of levy of customs duties, GST, income tax and like. In Gift City there is freedom to transact in foreign currency without being subjected to exchange control regulations (FEMA). The objective or offering regime of SEZs is that of increasing investment in India with all the incidental benefits of employment, additional business to local vendors of goods and services besides capital formation within the country. Numbers would indicate the benefits derived. Similar is the current PLI scheme and the benefits are already visible in terms of significant investment flowing into India, establishment of new world class manufacturing facilities, employment generation, foreign currency earnings and so on.

Similar benefits would accrue from virtual/deemed non-residency in services sector where investment can be targeted be it education, tourism, health or others.

Such a regime would, in most scenarios, not be revenue erosive from tax perspective as most of these individuals currently do not contribute to tax revenue in India on their income earned or accrued outside India. While a detailed economic analysis of the possible scheme and benefits offered would determine actual gain, a back of the envelope calculation would indicate that even if some tax revenue is to be lost, the overall benefit would offset any likely revenue loss.

Similar to the non dom rules for individuals a number of countries encourage **holding companies of multinational groups** to establish themselves in the country generally, through the means of an exemption, like the participation exemption given by Netherlands and UK whereby a company set up in Netherlands or UK

and holding, directly or indirectly, more than a specified threshold (often fixed at 10%), of the shares of operating companies set up in other countries are given total exemption from taxation of dividend income and capital gains arising on sale of the shares of the eligible operating companies. The exemption can be extended to all Income such as royalties and technical service fees derived from the eligible operating companies.

This exemption would increase the number of such holding companies established in the country together with the benefits for service industries in the fields of accounting, taxation, law, banking and like. This would be one of the means of achieving global size for Indian service providers, an aspiration expressed by the honourable Prime Minister. It would also increase the opportunities for the huge number of skilled persons, amongst the largest in the world, who can offer these services.

Another initiative that needs tweaking to address practical challenges is that of **facilitating reverse flip**.

Corporates particularly, start-ups and new age businesses follow money; they locate where there is availability of funds. At a time when Indian capital markets as also private investors did not give sufficient value for the potential of these companies, they chose to locate ownership of these companies outside India where they could raise funds through both, private equity and public markets deriving, better values. This was necessitated to overcome initial hurdles from funding requirements, talent hiring and achieving a degree of maturity. These corporates (foreign companies established by Indian entrepreneurs) continue do business in India given the size of the market.

Indian capital markets have now come of age and a number of these foreign holding companies are desirous of becoming Indian companies so as to access capital which Indian public markets as also private investors, in particular, HNIs are now capable of providing at attractive values. India has made policy changes to enable this reverse flip by activating company law provisions which permit cross border mergers of foreign companies into Indian companies including their Indian operating subsidiaries.

Simplifying this regime will facilitate such reverse flips.

One such measure would be to permit specified cross border mergers through filing with company law authorities (Regional Directors) instead of having to approach the Tribunal, which is quite time consuming. These changes have already been implemented for some types of cross border mergers whereas they are proposed¹ for other types including unlisted Indian companies with low debt (< INR 50 cr) and no defaults, non-wholly owned subsidiaries of Indian or foreign holding companies, and fellow subsidiaries within the same group.

Another area which needs addressal in reverse flip is the commercial issue around ownership of Intellectual Property Rights which are registered in various jurisdictions when the change in ownership takes place in cross border merger. The change in identity of the holder of the IP from a foreign company to an Indian company may require registrations in multiple countries. Several tax and FEMA issues arising in such reverse flips also need resolution.

These can be mitigated by providing an option to the

companies seeking to reverse flip to India by grant of permission to change their domicile/registration to India. This would avoid going through a process of merger involving the dissolution of the current equity holding company. In a re-domiciliation, the legal entity, the holding company would remain the same, the only change being that it would be registered in a different country. The position is similar to that of an individual changing his nationality. The individual is the same person though he is recognised as the national of a different country. This should not have any tax issues.

A tax problem affecting most cross border mergers revolves around the tax treatment of the merger transaction where the country in which the transferor company is registered does not permit companies registered in that country to merge into a company registered in a different country. It then becomes necessary to go through a process of winding up and dissolution of the foreign company. This is true of a number of countries particularly, European countries. The question which then arises is whether the tax consequences in India of such winding up or dissolution in foreign jurisdiction will be those of a merger which, by policy and prescription in the Income Tax Act, is to be tax neutral or the tax consequence applicable to a receipt pursuant to winding up and dissolution of the transferor. A clarification confirming that an amalgamation approved by an Indian Tribunal will, for purposes of Indian tax, be treated as a merger will go a long way in providing certainty, a feature which businesses are looking for.

Before concluding, another area that is also as essential to address and cannot be lost sight of is that of other source of risk capital, Foreign Portfolio Investment (FPI) as opposed to Foreign Direct Investment (FDI) reflected above. Given the maturity that the Indian stock markets have achieved, large numbers of individual non-resident investors, in addition to the institutional investors like mutual funds and insurance companies, have entered Indian capital markets in a reasonably large way. That said, this has potential to grow multi fold with change in

tax policy relating to taxation of long term capital gains.

Returning to the regime of total exemption to long term capital gains on equity investments by foreign investors should help FPI inflows as it improves the yield from Investment in India. Presently, this exemption is available to sovereign wealth funds and pension funds, being funds notified for this purpose by CBDT, for investment in infrastructure companies, whether direct or through AIFs, InvITs or NBFCs, with different thresholds of the extent of investment in infrastructure. About 50 to 60 funds have been notified for this exemption so far.

Most developed countries grant exemption from long term capital gains tax to non-resident investors without requiring any notification of such investors. The logic of granting such an exemption is that an investor can choose where to invest from several developed and developing economies, many with mature and established capital markets promising attractive returns. Tax exemption and the consequential improvement in after tax income would be one of the strong reason to choose India. The investors would, of course, be liable to tax in their home country and, if they are residents of a country which does not charge capital gains tax (e.g. Singapore), the avoidance is a consequence of the home country giving the exemption and that ought not be a consideration for policy decisions in India. Fiscal loss of tax revenue from such exemption, with adequate safeguards, ought to be weighed against the benefit of increased investment in equities and the resultant boost to Indian capital markets as also to businesses seeking risk capital. Additional revenue generated from such investments may, more than offset, fiscal loss.

In-depth examination of and possible introduction of tax and other regulatory changes, some of which are outlined in this article, are, though, not the only ones, but, one of the key factors in attracting global investment, is a given. Re-imagined, innovative and bold tax and regulatory changes could prove to be a fast speed driver in our journey to becoming a developed nation by 2047!

¹ Proposed draft amendments issued on April 5, 2025 inviting comments/ feedback by Ministry of Corporate Affairs