

# KEY AMENDMENTS OF BUDGET 2023 AFFECTING DEALS

## PRIMARY INVESTMENT FROM NON-RESIDENTS BROUGHT UNDER THE TAX NET WHERE IT EXCEEDS THE FAIR VALUE

- Budget 2023 has proposed that primary investment in a private company<sup>1</sup> from non-residents will need to be at FMV<sup>2</sup>, failing which the private company would be subjected to income tax on the excess value received from such investors.
- This provision is currently applicable to funding from residents, but Budget 2023, has extended the same to funding from non-residents as well.
- This is likely to create a challenging situation for private companies raising capital from non-residents. As per FEMA<sup>3</sup>, a non-resident cannot invest in equity instruments of an Indian entity below FMV. Thus, FMV is the floor price at which foreign capital can be introduced. On the other hand, any value higher than FMV will trigger taxation as per the amendment proposed in Budget 2023.
- This implies that the FMV is the Floor as well as the Cap.
- In several transactions, there are investments into Indian companies whose valuations are pegged to future performance. Conversion rules are pegged to trigger events in future and some of these conversions also have a downside price protection, i.e., if the Indian companies do not perform at the aspirational standards, then the foreign investor is required to get a better valuation for its investment.
- Challenges will also arise where investments from non-residents are in tranches and that too at fixed valuations.
- All such transactions will now need to be structured more carefully due to the interplay of income tax and foreign exchange regulations. Convertible instruments and conditionalities attached will need to bear in mind any tax exposure arising due to this amendment.
- Further, this amendment will require private companies to have the valuation exercise done from an income tax perspective every time they raise capital from non-residents. This will increase the cost of raising capital as well as compliance burdens.
- This amendment does not affect
  - Investments in start-ups which are registered with DPIIT<sup>4</sup> and meet the prescribed conditions; and
  - Investments made via AIF - Cat I and II and Venture capital fund (which meets prescribed conditions).

## START-UP SPECIFIC AMENDMENTS

- The ability to carry forward accumulated losses of start-ups is extended from 7 years to 10 years of incorporation. The 51% shareholding condition continues to be applicable.



- The Sunset clause of obtaining an exemption for start-ups is extended by a year to 31 March 2024. Thus, more targets can be registered as start-ups and be eligible for tax exemptions.

## PROHIBITING TAX COST ON SELF - GENERATED INTANGIBLES ON SALE

- Budget 2023 has proposed that the cost of acquisition and cost of improvement of self-generated intangible assets shall be "NIL". Thus, targets will not be able to claim cost deductions on the sale of self-generated intangibles for tax purposes.
- Some targets prefer to capitalise the cost of self-generated intangibles in their balance sheets for reflecting their true EBITDA position. Also, the capitalisation of intangibles can be triggered due to accounting requirements. Thus, where targets fail to claim depreciation on self-generated intangibles, they may end up paying higher taxes due to non-deduction of capitalised expenses and at the same time the tax provisions prohibiting deduction of cost on sale of such assets.

## LIMIT INTRODUCED FOR TAX EXEMPTION ON INVESTMENT OF CAPITAL GAINS IN RESIDENTIAL HOUSE PROPERTY

- In several VC/PE transactions, the promoter sellers being individuals/HUFs<sup>5</sup> contemplate optimising their capital gains tax arising on exits by investing in residential house property.
- Budget 2023 has introduced a monetary limit of INR 10 Crore (Approx USD 1.22mn<sup>6</sup>) to such exemption. Thus, the tax outgo for sellers will be higher where the re-investment plan was linked to investment in residential house property.

<sup>1</sup> This excludes company where public are substantially interested

<sup>2</sup> Fair Market Value

<sup>3</sup> Foreign Exchange Management Act, 1999

<sup>4</sup> Department for Promotion of Industry and Internal Trade

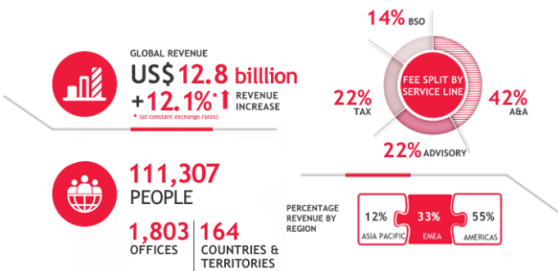
<sup>5</sup> Hindu undivided family

<sup>6</sup> Converted using exchange rate of INR 82.18 = USD 1

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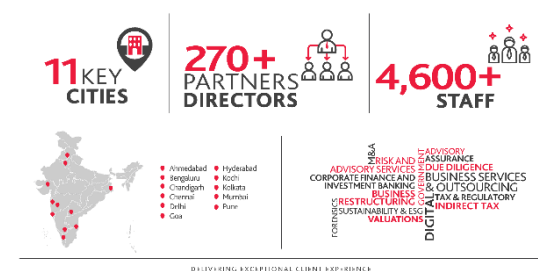
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\*Note: Financial results are as of 30 September 2022

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