Budget 2012 – 13: A mixed bag for QFIs, NRIs and FIIs

Silver lining for Qualified Foreign Investors (QFIs) in Budget's dark clouds

Investment in corporate bonds

Budget 2012 – 13 has proposed to allow qualified foreign investors (QFIs) to invest directly in corporate bonds of Indian companies. Qualified foreign investors are foreign individuals, groups or association of persons registered outside India who do not violate any eligibility norms for investment in Indian markets.

This measure will benefit both the QFIs and Indian companies as this will enhance the liquidity of the debt market and is likely to bring down their cost of borrowing as well. Indian companies are currently paying one of the highest bond yields in the world. Average yield on five year bonds of Indian companies during much of 2011 hovered at around 9.57 per cent. The average yield on Chinese corporate bonds during this period was 4.88 per cent. QFIs can earn these high yields by investing in corporate bonds of Indian companies. India's bond market currently lacks the kind of depth which is necessary for an efficient market and this move will go a long way in increasing it.

Non- Resident Indians:

Investment in corporate Bonds by QFIs

Non-Resident Indians too will benefit from the move to allow QFIs to invest directly in corporate bond markets. NRIs were technically allowed to invest in Indian corporate bonds. However companies issuing bonds needed to take permission from RBI for allowing subscription by NRIs. Now that QFIs can invest in corporate bonds, Indian companies will no longer have to take special permission from NRIs. NRI investments in Indian corporate bond market will therefore see a rise.

Mandatory foreign asset Reporting

Budget 2012 – 13 has proposed mandatory foreign asset reporting by Indian residents. This announcement may affect those Non – Resident Indians who have returned to India after long stints abroad. They will have to report any foreign assets that they acquired during their stay abroad.

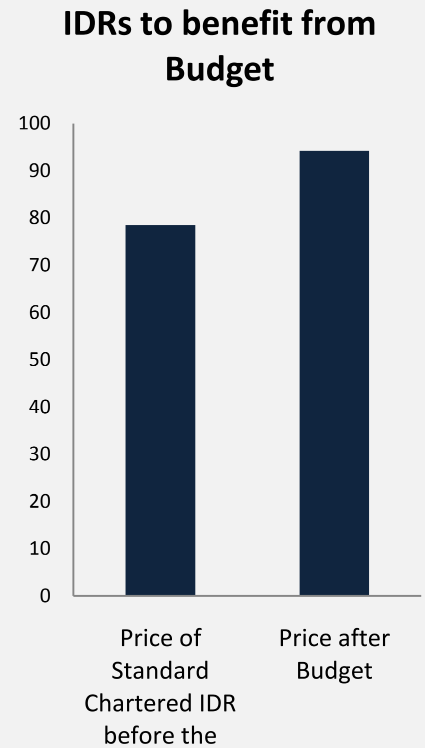
Also the budget has raised the retrospective tax investigation limit to 16 years. This means that income tax authorities can now open tax investigations dating back to 16 years. This may again have some adverse impact over those NRIs who return back to the country.

Deferment of the Direct Tax Code

The Direct Tax Code, which will replace Income Tax Act, 1961, will not be tabled in the Budget session of the parliament. This is good news for NRIs. Some of the provisions of the current DTC code go against them. One of these provisions is that NRIs and Persons of Indian origins (PIOs) will be classified as Indian residents if they stay in India during the financial year for more than 60 days. They will also be classified as Indian resident if they stay for more than 365 days or more over a period of four years prior to the assessment (financial) year. The classification as an Indian resident means that the global income of NRIs / PIOs during the financial year in which they are classified as such will be taxed in India.

Increase in customs duty on gold

This states that NRIs who bring gold from abroad to India will find it more expensive to do so now. Since prices of gold and gold jewellery is lower in many developed countries than in India (because of huge demand for gold in India), it has been a usual practice by NRIs to bring gold into India while visiting it. The increase of customs duty on gold will discourage this practice.



Foreign Institutional Investors and Foreign Companies

Two way fungibility of IDRs

Budget 2012 – 13 has proposed to allow two-way fungibility of Indian Depository Receipts (IDRs).This allows foreign investors to buy Indian listed IDRs and sell them in the London stock markets. The move will encourage many UK and other foreign companies to raise money from Indian markets by getting their shares listed in Indian markets through IDRs. However, the government still shied away from proposing non-directional (not limited to some countries only) fungibility. For a capital – scarce economy non-directional fungibility of IDRs is an indispensable requirement.

FIIs too will benefit from this provision because it will increase the investment avenues currently available to them in the Indian markets. It will also increase the liquidity of the markets leading to a more efficient mechanism for price discovery. After this announcement Standard Chartered's IDR broke its circuit limit of 20% and touched an intra-day high of ₹94.20.

Allowing Investments in long term infrastructure bonds

Budget 2012 – 13 allows foreign institutional investors to invest in long term infrastructure bonds. This is an announcement in favour of Foreign Institutional Investors as it will increase the investment opportunities available to them in India.

Retrospective taxation of foreign asset transactions for assets located in India

The announcement to tax foreign asset transactions for assets located in India retrospectively from 1961 comes as a big jolt to foreign investors. The proposal aims at overturning the Supreme Court verdict in the Vodafone case that had gone in favour of the company and had raised the spirits of foreign investors.

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