

Syllabus subtopic:

- Government Budgeting.

Prelims and Mains focus: About steps taken to boost private investment; associated terms and their meaning

News: Finance minister took several measures to woo foreign portfolio investors (FPIs) after the misstep last year on imposing a surcharge on investors which were registered as a trust.

What are steps to be taken?

1. **withholding tax** rate of 5% for FPIs investing in the bond market
2. eliminating the **dividend distribution tax (DDT)**
3. letting FPIs claim credit in home jurisdiction
4. Full tax exemption for **sovereign wealth funds** if they invest in infrastructure and other notified priority sectors. The sectors include roads, highway projects, ports and water supply projects.

Significance of the move

- The steps showcase how the government is seeking to tap private capital, especially foreign funds, to revive economic growth at a time when the government’s balance sheet is stretched.

- The Centre tried to pull all stops in reaching out to foreign investors in the budget.

About Withholding tax

- Withholding tax is **deducted at source**, and is levied by some countries on interest or dividends paid to a person residing outside that country. The withholding tax was so far allowed only until July 2020, which has been extended to July 2023. The amendments are effective from the next fiscal.
For investments made by FPIs in bond market instruments such as government securities, corporate bonds, municipal bonds, the government has set the withholding tax rate at 5%. In its absence, the tax would have depended on double taxation avoidance agreement or tax treaties so could go up to 15%. Under the treaty, the tax outgo is capped at 15% for the US.

About Sovereign wealth fund

- A sovereign wealth fund is a state-owned investment fund that is used to benefit the country’s economy and citizens.

- Funding comes from central bank reserves, currency operations, privatizations, transfer payments, and revenue from exporting natural resources.

- Funds tend to prefer returns over liquidity and are therefore more risk-tolerant than traditional foreign exchange reserves.

- Acceptable investments in each SWF vary from country to country.

- Sovereign wealth funds such as Abu Dhabi Investment Authority and Singapore’s GIC have invested billions of dollars in India, especially in infrastructure and energy sectors. They are considered as patient investors with extremely deep pockets and very long-term investment horizons.

About Dividend Distribution Tax (DDT)

- DDT is a tax levied on dividends that a company pays to its shareholders out of its profits.

- It is taxable at source, and is deducted at the time of the company distributing dividends.

- The dividend is the part of profits that the company shares with its
shareholders.

- The law provides for the DDT to be levied at the hands of the company, and not at the hands of the receiving shareholder. However, an additional tax is imposed on the shareholder, who receives over Rs. 10 lakh in dividend income in a financial year.

- The **biggest beneficiary of eliminating DDT are foreign funds**, as they won’t just pay tax as per rates negotiated under various treaties but can also claim credit in their home jurisdictions on tax outgo in India.

**What Is Foreign Portfolio Investment (FPI)?**

- FPI consists of securities and other financial assets held by investors in another country.

- It does not provide the investor with direct ownership of a company’s assets and is relatively liquid depending on the volatility of the market.

- Along with foreign direct investment (FDI), FPI is one of the common ways to invest in an overseas economy. **FDI and FPI are both important sources of funding for most economies.**

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<th><strong>Pros</strong></th>
<th><strong>Cons</strong></th>
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<tr>
<td>Feasible for retail investors</td>
<td>No direct control/management of investments</td>
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<tr>
<td>Quicker return on investment</td>
<td>Volatile</td>
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<td>Highly liquid</td>
<td>Cause of economic disruption (if withdrawn)</td>
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