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Union Budget 2008-09: Much Left Unsaid for the VC/PE Ecosystem

(Guest Column: Shantanu Surpure, Managing Attorney/Advocate at Sand Hill Counsel, a Mumbai and Silicon Valley-based law firm, writes on the Budget 2008-09 and what it means for the PE/VC ecosystem. Shantanu was assisted by advocate Anand Kumar of Sand Hill Counsel.)



While today's Budget had much for the rural sector including announcements regarding debt relief, the headline for the VC/PE ecosystem was that much was left unsaid and that we need to stay tuned for further developments.

Below is an analysis of some of the key issues and their impact on the ecosystem:

-Some predictions were made about corporate taxes being reduced – this remains unchanged. Instead, short term capital gains taxes were increased to 15 per cent to 10 per cent. Perhaps the underlying idea was to encourage investors to take a longer term view and reduce volatility in the markets – although a negative from an individual standpoint, there may be merit from a macro view.

-The Dividend Distribution Tax (DDT) remains unchanged but one positive development for those involved in structuring holding company transactions is that it has been clarified that the dividend of a subsidiary company is exempt from DDT. However, further clarification may be needed in multi-tiered holding company and subsidiary structures.

-While much has been said about the state of India's infrastructure and the need for increased investment in this sector, the main items mentioned were with respect to the development of derivatives market for bonds (which should assist in financing) and the granting infrastructure status to the natural gas industry.

-The deal community was most concerned with announcements regarding:

- (i) taxing offshore holding companies in M&A transactions resulting in the sale of downstream Indian entities or assets;
- (ii) amendments to double taxation treaties such as the Mauritius-India Treaty which may result in the removal of the capital gains benefits;
- (iii) considering offshore subsidiaries of Indian companies as Controlled Foreign Corporations (CFCs) and bringing them into the tax net;

(iv) removal of the last Budget's amendments regarding amendments of tax pass-through benefits for domestic venture capital funds;

(v) removal or amendments to Fringe Benefit Tax, only slight amendments were made which do not impact ESOPs; and

(vi) extension of the Software Technology Parks of India (STPI) tax benefit which is expiring shortly.

It appears that for the above, the message seems to be "stay tuned". The Finance Minister did specifically state that "capital inflows are in excess of the economic deficit and the inflow of funds will be monitored".

Therefore, foreign direct investment (FDI), foreign institutional investor (FII) investment and external commercial borrowings (ECBs) are clearly on the Finance Minister's radar screen and we may expect to see further announcements including in the abovementioned areas which concern the VC/PE ecosystem.

(Shantanu Surpure is Managing Attorney/Advocate at Sand Hill Counsel, a law firm with offices in Mumbai and Silicon Valley. He focuses on venture capital and private equity transactions. Shantanu holds a BA from Brown University/London School of Economics, an MA Juris from Oxford University and a Juris Doctor from Columbia Law School and is admitted to practice law in India, California, New York and England and Wales. He can be reached at ssurpure@sandhillindia.com)

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