Budget 2013: Easier norms for equity investments, removal of cap for FIIs expected

Finance Minister P Chidambaram may announce extensive changes in the regulatory regime governing capital markets in the upcoming budget, including scrapping the cap on the amount foreign institutional investors can invest in rupee corporate debt and putting in place a simpler regime for foreign investors in stocks and bonds.

Further, the minister may also unveil a simpler version of the Rajiv Gandhi Equity Savings Scheme, which is meant for new investors, relax stringent know your customer (KYC) norms for individuals, and come up with tax sops for certain mutual fund products.

"The budget will have a strong package for the capital markets," said a finance ministry official privy to the discussions.

India needs to attract foreign capital to bridge its current account deficit that is projected to worsen to 4.4% of GDP due to rising import of gold and crude oil.

In the current year, foreign institutional investors have invested $8.7 billion in buying up Indian stocks and debt, over and above the $31 billion they brought in last year. But stock market sentiment has soured in the past few weeks, as the impetus generated by reform measures announced since September 2012 begin to fade.

Carnage in Mid and Small Caps

The Sensex is down nearly 3.5% from its January 21 peak of over 20,000, but the carnage is more in the mid-caps and small caps, a trend the budget will be looking to reverse.

Making investments in the capital market more attractive is also expected to moderate investor fascination for gold. Deepening the corporate bond market has long been identified as a priority area by the government and the budget could announce several measures towards this end, including removing the withholding tax on interest payment, besides doing away with the cap on foreign investments in debt.

Alternatively, the foreign investment limit could be specified in terms of percentage of the issue size.

Various panels, including a high-powered expert committee on making Mumbai an international finance centre, had suggested removing the cap on foreign investments in debt that currently stands at $25 billion.

"Caps may be coming in the way of flows...It would be a good idea to introduce some flexibility, especially at this juncture when yields are attractive," said Jyoti Rai, head, business development, SBI-Soc Gen Custodial Services.

The withholding tax is currently 5% on infrastructure bonds and 20% on corporate bonds, and is widely regarded as an irritant.

The finance ministry is also looking to unify various regulatory regimes that govern investments in stocks and debt.

This could be done, officials said, by extending the framework governing qualified foreign institutional investors, essentially family offices and wealthy individuals, to foreign institutional investors, non-residents and venture capital funds.

The ministry could also allow qualified foreign investors to invest over and above the foreign direct investment cap in sectors where there is no limit specified by Parliament.

In a series of overseas road shows earlier this month, Chidambaram had promised to unveil more measures in the budget to make the country's regime friendlier to foreign flows.

"The idea is to create vibrancy in the stock market by making the overall investment framework attractive for both domestic and foreign investors," the official quoted earlier said, adding that measures to boost savings are on the cards.

One of the options is to create an investment cult in the country through the Rajiv Gandhi Equity Savings Scheme by making it simpler, increasing incentives and making it available to more investors.

"The scheme should be able to attract the young working population that has just started earning," said the official.

While unveiling the scheme in Mumbai, Chidambaram had said he would be looking at making the scheme more attractive and simpler.

Currently, the scheme allows a maximum rebate of Rs 25,000 (50% of maximum annual investment of Rs 50,000) for first-time investors in equities.

The budget could increase the annual investment allowed under the scheme or allow for 100% rebate, and throw it open to a broader category of investors.

Another government official privy to the discussions said the ministry could also look at slashing the securities transaction tax (STT), but that would be contingent upon the government being able to make up through other taxes.

Market participants have been demanding a reduction in the STT, which is levied at the rate of 0.1% on sale or purchase value of shares transacted through stock exchanges.

(Economic Times)