FPIs Want Tax Trigger Cap Raised from 5% to 26%

Foreign investors, spooked by the tax department's recent decision to tax them under indirect transfer provisions, have approached the government for respite. These investors have proposed to the government that the ownership threshold limit for triggering the tax law should be raised from 5% to 26%. This would keep most FPI transactions outside the ambit of this rule.

The Central Board of Direct Taxes (CBDT) on December 21 clarified that foreign portfolio investors, private equity and venture capital funds would fall under the ambit of indirect transfer provisions, the contentious law which led to the long drawn legal battle between telecom major Vodafone and the government.

As per this law, all FPIs, having more than 50% o assets under custody in India and owning over 5% stake in any listed entities would incur tax under indirect transfer provisions. This would result in overseas investors paying taxes twice--one in the home country and one in India. Most FPIs invest through special purpose vehicles that are India focussed with more than 50% assets invested here. “Apart from exposing the funds and their investors to the risk of double taxation on the same stream of income, the recent clarifications create a disastrous recipe for more litigation, more so if it is applied retrospectively leading to high uncertainty for FPIs,” said Siddharth Shah, partner, Khaitan & Co.

Sources said representatives of various foreign institutions and India Venture Capital Association have met the finance ministry and senior tax officials over the past few days. The law under Section 9 (1Xi) of the Income Tax Act says all income arising from asset or source of income in India or through the trans through the transfer of a capital as set in India shall be deemed to accrue or arise in India and taxed here. The Act exempts investors holding less than 5% of the total voting power or share capital having direct or indirect assets in India.

FPIs have also said that if shares or units of funds are listed offshore, indirect transfer provisions should not ap ply at all. Also, there should be no TDS obligations for FPIs and corporate restructurings should not trigger indirect transfer provisions. “We are confident that government is keen to welcome foreign capital for its flagship initiative sand they would stead fastly address genuine concerns of the fund industry,“ said Rajat Tandon, President, India Venture C a p i t a l Association.

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