Relief for FPIs, CBDT puts tax liability circular on hold

In a major relief to foreign portfolio investors (FPIs) in India and the overseas investors in these funds, the Central Board of Direct Taxes (CBDT) on Tuesday put in abeyance its December 21 circular that amplified their concerns over a potential rise in tax liability under India's controversial indirect transfer provisions.

In a major relief to foreign portfolio investors (FPIs) in India and the overseas investors in these funds, the Central Board of Direct Taxes (CBDT) on Tuesday put in abeyance its December 21 circular that amplified their concerns over a potential rise in tax liability under India's controversial indirect transfer provisions. Tax experts said that the decision to not implement the circular, coming as it does ahead of Budget FY18, signalled the government's intent to spare small overseas investors in FPIs registered in India from paying taxes in India on redemption of shares/units.

The December circular, which reiterated the provisions under Section 9 of the Income Tax Act, suggested that sort of double taxation: India-registered FPIs pay taxes in India on direct transfer of shares in Indian companies and the investors in them too are liable to tax in India under the indirect transfer provisions on redemption of units by the portfolio investors. Although a special carve-out was given to small investors holding 5% or less in a fund and without any right of management or control, this was felt grossly inadequate and inconsistent with the FPI investment structure. According to Ketan Dalal, senior tax partner at PwC, the government might raise the carve-out threshold to 51% or at least 26% so that India-focused FPIs' ability to pool money from retail and institutional investors to invest in Indian stocks won't be circumscribed. This would require an amendment to the I-T Act.

Foreign portfolio investors have pulled out as much as $11 billion from the Indian markets in the October-December quarter, with analysts blaming demonetisation for the outflow. Securities and Exchange Board of India chairman U K Sinha said on Tuesday that the impact of the note ban on the outflows was being analysed.

The indirect tax provisions have their genesis in the government's decision to overrule the Supreme Court judgement in the Vodafone case via a retrospective amendment in the Finance Act, 2012.

According to the amendment, "If an asset, being a share or a interest in a company or entity, registered or incorporated outside India, derives its value, directly or indirectly, substantially from an asset situated in India, the gains arising from the transfer of such share or interest would be taxable in India." And it was clarified that the value will be deemed to be derived from India substantially if more than 50% of the total assets of the fund are from India and value of the assets exceed R10 crore.

While the indirect transfer rule itself was considered to be regressive, the rules that brought the overseas investors also under its ambit annoyed the investor community even more. The December 21 circular, in the form of answers to 19 FAQs, only stressed the relevant changes in the I-T Act and offered no relief to investors.

The government had stuck to the stand, despite the Shome committee observing that indirect tax provisions would result in taxation at every upper level of investment in an FPI structure and multiple taxation of the same income. “It is necessary to exclude all investors above an FPI from the tax net in respect of an FPIs’ investment in India,” BMR Advisors wrote.

There is also an issue of compliance burden arising from Section 9 of the I-T Act. Companies whose shares are traded by FPIs, for instance, will need to report each transaction to the taxman.

The CBDT said on Tuesday: “Circular No. 41/2016 was issued on 21.12.2016 which dealt with clarification on indirect transfer provisions. After the issue of the afore mentioned circular, representations have been received from various FPIs, FIIs and VCFs and other stakeholders. The stakeholders have presented their concerns stating that the circular does not address the issue of possible multiple taxation of the same income. The representations made by the stakeholders are currently under consideration and examination. Pending a decision in the matter the operation of the above mentioned circular in kept in abeyance for the time being.”

(Financial Express)