

## Tribunal grants tax relief for FIIs using forex forwards

A recent ruling by the Income Tax Appellate Tribunal (ITAT) has come as a big relief for foreign institutional investors (FIIs) hedging their currency risks through forward contracts with banks.

The Mumbai bench of ITAT has held gains arising on cancellation of foreign exchange forward contracts should be treated as "capital gains". The decision came in an appeal by Credit Suisse (Singapore) against the tax department's view that such gains be treated as income from other sources. Under this head, these transactions would have attracted a tax of up to 42 per cent, according to experts.

The Singapore-based sub-account had contended that being a foreign investor, it was holding shares on capital account. Therefore, the gain/loss on the foreign exchange forward contracts, which had been entered into by it only for the purpose of hedging, would also be characterised as capital in nature. The tribunal upheld this position.

C R Sasikumar, managing director and chief executive officer of SBI-SocGen Global Securities, said the move was positive for FIIs, as it gave a clear direction by removing any ambiguity in the interpretation for FIIs and relevant tax consultants. According to him, this will be applicable to all FIIs irrespective of the jurisdiction they come from. "Post this, there will be consistency in the practice by tax authorities," Sasikumar added.

Foreign investors, who invest in different markets, often enter into forward contracts to protect themselves against the risk of currency rate fluctuations. Over the past one year, the Indian currency has seen huge volatility, falling to around 56-levels against the US dollar. In August 2011, the rupee was trading at 44-levels against the dollar.

"Hedging is a measure any prudent investor would take to protect his investments from the vagaries of currency (movements). Following the judgement, the gains made on these forwards would be treated as capital gains," said Naresh Makhijani, partner, KPMG. Since most foreign investors invest in India through treaty jurisdictions, such as Mauritius and Singapore, these capital gains would be exempt from tax, experts said.

The I-T department had earlier held such gains would be treated as income from other sources. "The latest decision of the ITAT would be of great interest to such FIIs and sub-accounts, particularly those registered in Mauritius and Singapore since capital gains earned by such entities would be exempt in India by virtue of the tax treaties between India and these countries," according to a note by SKP group, a Mumbai-based consultant.

ITAT held the gains realised by the tax payer on foreign exchange forward contracts are in the nature of capital gains covered under Article 13(4) of the tax treaty. For this, ITAT placed reliance on the decision of ITAT in the case of Citicorp Investment Bank (Singapore) Ltd. ITAT further held the tax department's reliance on the Calcutta High Court's decision in the case of All India Tea and Trading Co Ltd could not be upheld since the facts of that case were totally different from the facts of the present case, the SKP note added.

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