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As FIIs drag feet, QFIs queue up to buy India

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Contrary to the perception that foreign equity investors are giving up on India, a large number of private banks and wealthy investors from Europe, the US, Canada and the Asia Pacific (Apac) region are preparing to invest in Indian stocks via the qualified financial investor (QFI) route, though they await minor clarifications on the computation of withholding tax and rate of taxation, top officials at qualified depository participants (QDPs), which will be the sole nodal points for such overseas investors, said.

“We see a huge potential, with flows originating through private banks and wealth managers in Europe, the US and Canada. Even the entire Apac territory will be a good contributor to the inflow,” Atul Gupta, managing director of Orbis Financial, a Sebi-approved QDP, who returned from Europe recently and saw the QFI potential, told Financial Chronicle.

Until now, foreign access to India’s equity and mutual fund markets has largely been restricted to institutions and funds with a broad base of investors. “The new QFI rules change all that — opening up India’s $1.6 trillion equity market to virtually all categories of investors,” said Citi, a Sebi-approved QDP, in a note to clients.

QFIs open the market up to most classes of investor (both institutional and retail), including private banks and their clients, family offices, partnerships, firms and individuals.

“This is a game-changer,” said Citi’s Debopana Sen, securities country manager for securities and fund services, India.

For QFIs no registration is required, so time to market is lot shorter. The key requirement is that QFIs must open a securities account with a QDP, which is responsible for routing a QFI’s trade orders to brokers. Unlike FIIs, QFIs will not be permitted to place orders directly with brokers.

Concerns were raised by some overseas QDPs, which wanted QFI rules on tax to be similar to the regime applicable to foreign institutional investors, where there was no threat of future tax liability arising against the custodian banks. Which means, QDP is responsible for deducting tax at source before repatriating funds.

There is also no clarity on how dividends from companies from QDPs’ account will be transferred to the QFIs accounts overseas, industry players said.

“We see a lot of potential, especially from West Asia, to enter the Indian equity market through the QFI route,” said CJ George of Geojit BNP Paribas Financial, which is also among the 25-Sebi approved QDPs.

This is contrary to popular perception that foreign institutional investors (FIIs) are exiting India following concerns related to General Anti-Avoidance Rules or GAAR.

For firms like Geojit BNP Paribas, which have significant presence in West Asia, the major concern is the current stipulation that QFIs from only financial action task force jurisdiction would be eligible.

Though FATF includes 34 jurisdictions and two regional organisations including the Gulf Co-operation Council, several Gulf countries are not in the FATF. “We expect some clarifications allowing investors from all West Asian countries eligible to enter the Indian stock market QFIs,” said George.

Under the FII regime, custodian banks get to hold interest free money from foreign investors, who buy and sell stocks on Indian bourses. However, in the QDP regime, the maximum retention period of a QFI’s funds in the single rupee pooled account with QDP is just five working days, during which period it has to either reinvest in Indian equities or mutual funds, or repatriate the money back to overseas investors.

“The foreign custodian banks do not like this provision, hence the opposition,” said an official in another QDP, without wanting to be named.

However, Siddharth Shah of Nishith Desai Associates, a corporate law firm, said QDPs' concern on future tax liability is legitimate. “The concern is that there should not be any future tax liability on QDPs for some tax-related issues by QFIs in the future,” he said.
Gupta of Orbis Financial said: “In the case of FIIs, there is no threat of future tax liability arising against the custodian banks. However, with QFI investments in India, there is a greater responsibility and liability on the QDPs with regard to tax liabilities of the QFI. Orbis is fully prepared with systems, controls and procedures and is well equipped to provide an end-to-end solution to QFIs.”
A senior official at another Sebi-registered QDP said he expects several FIIs closing their accounts to register afresh as QFIs. “There are several FIIs which manage funds of just two or three big foreign investors. These investors would prefer investing in Indian stocks as QFIs rather than FIIs, which will give them better flexibility in their investment decisions,” the official said.
What QDPs want is clarity and certainty on tax matters such as computation of withholding taxes, rates of taxation and the double taxation avoidance agreement (DTAA), he said.
At a recent Sebi meeting held by its deputy general manager S Madhusudhanan, an official at a foreign brokerage said QDPs were not prepared to take the burden of QFIs' future tax liability, say in case the government decides to tax at the rate of 30 per cent instead of 15 per cent (short tax capital gains).
Sebi-registered foreign QDPs include Citibank, HSBC, Deutsche Bank and BNP Paribas.
“We expect the tax concerns of the QFIs to be clarified following the passage of the finance bill, especially the grey areas relating to computation of withholding taxes, rates of taxation and the DTAA implications by the end of May,” said Gupta of Orbis.

rajeshabraham@mydigitalfc.com
